

**THE ROLE OF SOCIAL SECURITY, DEFINED  
BENEFITS, AND PRIVATE RETIREMENT ACCOUNTS  
IN THE FACE OF THE RETIREMENT CRISIS**

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**HEARING**  
BEFORE THE  
SUBCOMMITTEE ON SOCIAL SECURITY,  
PENSIONS, AND FAMILY POLICY  
OF THE  
COMMITTEE ON FINANCE  
UNITED STATES SENATE  
ONE HUNDRED THIRTEENTH CONGRESS  
FIRST SESSION

DECEMBER 18, 2013



Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE

88-820—PDF

WASHINGTON : 2013

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For sale by the Superintendent of Documents, U.S. Government Printing Office  
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**THE ROLE OF SOCIAL SECURITY, DEFINED  
BENEFITS, AND PRIVATE RETIREMENT  
ACCOUNTS IN THE FACE OF THE  
RETIREMENT CRISIS**

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**WEDNESDAY, DECEMBER 18, 2013**

U.S. SENATE,  
SUBCOMMITTEE ON SOCIAL SECURITY,  
PENSIONS, AND FAMILY POLICY,  
COMMITTEE ON FINANCE,  
*Washington, DC.*

The hearing was convened, pursuant to notice, at 10:05 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Sherrod Brown (chairman of the subcommittee) presiding.

Present: Senators Wyden, Nelson, Cardin, Casey, Isakson, and Toomey.

**OPENING STATEMENT OF HON. SHERROD BROWN, A U.S. SENATOR FROM OHIO, CHAIRMAN, SUBCOMMITTEE ON SOCIAL SECURITY, PENSIONS, AND FAMILY POLICY, COMMITTEE ON FINANCE**

Senator BROWN. The Subcommittee on Social Security, Pensions, and Family Policy will come to order. Welcome to Ranking Member Senator Toomey, and to Senator Isakson too. I think others will join us.

This is likely the first of a series of hearings that Senator Toomey and I would like to do on the issues of retirement security, Social Security, and all that it relates to, and I appreciate his cooperation, as I do Senator Hatch's and Chairman Baucus's cooperation.

I will begin, of course, with an opening statement, turn it over to Senator Toomey for his, and Senator Isakson and other members who come are certainly welcome to do the same.

Retirement security in America, as we know from reading the histories of FDR and other stories from the New Deal on, has virtually always been thought of as a 3-legged stool: Social Security, employer-provided pensions, and personal savings and investment.

The first leg of the stool, Social Security, guarantees a modest, but stable income during retirement years, but it is not just for retirement security. Social Security provides basic financial security in the face of unexpected tragedy. Social Security provides a vital safety net to the disabled, the orphaned, widows, and widowers, something traditional retirement plans often are unable to provide.

The other two legs of this 3-legged stool—personal savings and pension plans—build upon the bedrock of Social Security and allow families to maintain the standard of living or approach the standard of living they enjoyed while they were working. It protects seniors, but also allows families to use their resources to buy homes, to start families, and to pay for education.

Without retirement savings, aging parents become dependent on their working-age children, preventing those children from saving for their own retirement, perpetuating the cycle of economic distress for far too many families in those retirement years.

So, for far too many workers, we have seen Social Security as the only leg left standing on the 3-legged stool. The percentage of workers covered by traditional defined benefit plans—those where you pay in and you get a defined benefit, likely for the rest of your life—has been declining steadily over the past 35 years. There are now only some 30,000 private sector defined pension benefit plans, down from over 100,000 less than 30 years ago.

From 1979 to 2011, the proportion of private workers with retirement plans covered by defined benefit pension plans fell from 62 percent to 7 percent. At the same time, the percentage participating in defined contribution plans, much more common now, which inherently hold more challenges for the beneficiary and perhaps others, increased from 16 percent to 66 percent.

Only half of America's defined contribution plans have auto-enrollment. At a time when we are told that we are in charge of our retirement futures, only one-quarter of American workers have automatic access to a defined contribution plan. About half the U.S. workforce today is covered by an employer-sponsored retirement plan, meaning that half of Americans, obviously, are not participating in any employer-sponsored plan.

Working families are increasingly squeezed from every angle. Wages are stagnant. Home values have declined in far too many cases. Tuition costs for children are increasing at the time we begin to care for our aging parents. Close to two-thirds of families overall, middle-class and low-income families, rely on Social Security for a majority of their retirement income.

Workers aged 50 to 64 are increasingly unprepared for retirement. The vast majority of economic gains in the last 25 to 30 years have gone to those at the very top of the income distribution in this country, also, obviously, affecting savings and retirement.

Middle-class workers have not shared in the economic gains, by and large, or seen increased income associated with increased productivity and higher corporate profits, meaning costs go up, but the ability to save has declined. The picture gets bleaker when considering racial disparities in wealth. The median wealth of white households is 20 times that of black households, 18 times that of Hispanic households—the highest ratios since the government began publishing this data a quarter-century ago.

These factors are why most Americans have saved only a fraction of what they need for retirement. Workers approaching retirement age have an average savings of less than \$27,000. One-third of Americans leading up to Social Security retirement age, one-third of Americans 45 to 64, have nothing, zero, saved for retirement at all. The numbers are only slightly better for workers with a retire-

ment plan. In 2010, 75 percent of Americans nearing retirement age had less than \$30,000 in their IRAs or in their retirement accounts or 401(k)s.

These facts illustrate how great the need is for, in my mind, maintaining and expanding Social Security, the only source of guaranteed lifetime benefits on which most retirees can rely. Social insurance—and this is social insurance, as are unemployment insurance and Medicare—with social insurance, you pay in, you get benefits out. Social insurance does not just provide much-needed financial support, it ensures that hardworking middle-class people can retire with dignity.

For a majority of recipients, these modest benefits provide over half their income, lifting over 22 million Americans out of poverty. As I said earlier, one-third of retirees, Social Security beneficiaries, rely on Social Security—close to one-third—for essentially their entire income. The program is not only retirement insurance, it is family income insurance. One-third of benefits go to children and widows and the disabled. One in 10 children today lives with a grandparent.

Rather than asking how we should scale back the program, we should be asking ourselves how we can strengthen it. That seems too often to be the debate on the talk shows: how we can scale back the program and save money for budget reasons, not the debate which I think it should be of, how do we deal with the whole issue of security, financial security, retirement security for people? That means not reducing benefits or raising the retirement age.

Maintaining or expanding Social Security is the single most effective thing we can do to prevent poverty and economic ruin for millions of senior citizens while promoting economic mobility for their children and grandchildren so that their responsibilities and burden do not increase to the degree that makes it so difficult for them.

The budget debate creates a vacuum that does not take into account the economic impact of Social Security benefits. A number of you, primarily Mr. Biggs and AARP, have written on that. So your comments will be interesting to hear.

Social Security benefit cuts would decrease our 10-year deficit, but such cuts, I do not think, consider the impact on seniors, their families which support them, and current middle- and low-income workers. It is not a simple budgetary issue. It is a macroeconomic issue. Shifting the cost from the Federal budget does not resolve the problems in our retirement and savings programs.

Social Security reforms should be considered as part of the Finance Committee's examination of the burgeoning retirement crisis. I see this hearing as an important first step.

[The prepared statement of Senator Brown appears in the appendix.]

Senator BROWN. I want to yield to my Ranking Member, Senator Toomey. I appreciate his cooperation. I think we will learn a lot from today's hearing, and I look forward to your contribution.

**OPENING STATEMENT OF HON. PATRICK J. TOOMEY,  
A U.S. SENATOR FROM PENNSYLVANIA**

Senator TOOMEY. Thank you very much, Chairman Brown. I appreciate your having this hearing.

This is, there is no question, an extremely important topic. We all agree on the importance of addressing retirement security. As you pointed out, Mr. Chairman, Americans rely generally on three main vehicles for financial security in retirement. There are the private savings that often come in the form of tax-deferred accounts. There are employer pensions, which, as you pointed out, are increasingly defined contribution plans. And there is the Social Security program.

In my view, the government policy should focus on protecting all three of these pillars of retirement security. There are a couple of ways we can approach this. One would be to recognize the strengths of the current retirement system and preserve what works. But the other thing we need to do is acknowledge the hard truths about reforms that are going to be necessary to protect programs that seniors depend on.

I think it is generally good to adopt the approach of, first, do no harm. One of the advantages of our current system is the diversity of saving options, whether it is 401(k)s or IRAs, pre-tax accounts, Roth-style accounts. The range of options gives taxpayers greater flexibility, more choices, and more opportunities to accumulate savings that will help them in their retirements.

I think we ought to defend and encourage these provisions that help people to save. Some have suggested that we ought to reduce the amount that Americans can save in tax-deferred accounts. I think that is a bad idea. It would tend to diminish savings. And, while that would have adverse consequences for individuals attempting to save and provide for their own retirement, I think it would also be counterproductive from an economic point of view.

The most important long-term driver of economic growth is the investment of accumulated capital—and it has to be accumulated before it can be invested. And so encouraging that savings over time maximizes economic growth.

A second point I would make is that we have to make sure that Social Security is going to be there for future generations. It is an extremely important program. You have talked about this; we all know this. For decades, it has provided seniors with a guaranteed source of income and kept millions of Americans out of poverty.

But the fact is the program, in its current form, is not solid. It has gone into a cash-flow deficit position since 2010. Benefits paid routinely exceed payroll taxes paid into the system by very large sums, which are only projected to grow. And I know people often like to invoke the assets in the trust fund, but, as we will probably get into in this discussion, there are no assets backing up anything in the trust fund.

This is a filing cabinet with certificates that have no real assets to back them up and, therefore, the trust funds to which we routinely refer do nothing to enhance or enable the Federal Government to honor the commitment it has made. And so we should not be under the illusion that that somehow makes things okay.



The challenges facing Social Security are not a partisan observation. I want to quote briefly, Mr. Chairman, from the Social Security Trustees' report of this year, 2013, in which they state, and I quote: "Both the Social Security and Medicare programs face substantial financing shortfalls that require legislative corrections. It is important to grasp that the amount of time remaining to enact a financing solution is far less than the amount of time projected before final depletion of Social Security's combined trust funds. If lawmakers take action sooner rather than later, more options and more time will be available to phase in changes so that the public has adequate time to prepare. Earlier action will also help elected officials minimize adverse impacts on vulnerable populations, including lower-income workers and people already dependent on program benefits."

So the final point I would make is that tax increases do not solve this problem, and it would be a mistake to go down that road. Actuaries have even analyzed the proposal that some have suggested: that we completely lift the cap on income that is subject to the payroll tax. Of course, that is a radical idea to change the program fundamentally and, in the process, to sever the link between taxes paid in and benefits received.

But even if that radical step were taken, it would only provide temporary relief. The cash flow deficits would return in just 11 years.

So again, Mr. Chairman, I thank you very much for agreeing to do this hearing. I am looking forward to hearing from our witnesses and having a discussion.

Senator BROWN. Thank you for your comments.

Senator CASEY?

Senator CASEY. Mr. Chairman, I will move right to the witnesses.

Senator BROWN. Senator Isakson?

**OPENING STATEMENT OF HON. JOHNNY ISAKSON,  
A U.S. SENATOR FROM GEORGIA**

Senator ISAKSON. I just want to thank the chairman for calling this hearing. There is probably no more important subject for us to be talking about. Everybody talks about the housing bubble and all the bubbles we have had. The big bubble coming is the pension bubble and the retirement security bubble for America.

My hometown of Atlanta, GA, the capital city of the State of Georgia, just finally faced up to the music and reformed their pension fund to try to make it actuarially sound for its beneficiaries in the future by reforming benefits, reforming contributions that go into the plan. But they finally faced the music.

I want to associate myself with what Senator Toomey said. We have to face the music too. We have to preserve those entitlements for which people have paid. In fact, most people in America who have paid taxes have paid more for their retirement security than they have income taxes. They paid it under the payroll tax, and they deserve the protection, and they deserve a Congress that is looking into the future, not just for them, but for their children and grandchildren.

As policymakers, we have to be willing to make some very difficult decisions, but make them in the context of our obligation to

the people we represent. So this hearing, as called, is most appropriate. The solutions are not easy, but Senator Toomey's comments about preserving the tax benefits and incentives of government policy to direct people toward more private savings are absolutely essential, because people have to become more dependent upon themselves and less dependent upon government. But we need to incentivize that contribution process so it is easier and easier for them to accumulate benefits over time and accumulate capital over time.

I look forward to participating in the hearing today and appreciate your calling it.

Senator BROWN. Thank you, Senator Isakson.

Let me introduce the witnesses, and then we will begin the testimony.

The first witness is Rob Romasco, president of AARP, who came to AARP after a distinguished career in the private sector and has written and spoken extensively on the wide-ranging impact of Social Security on our economy. Thank you for joining us, Mr. Romasco.

Andrew Biggs is resident scholar at the American Enterprise Institute. He has devoted his career to researching retirement savings and pensions issues and has served as the Principal Deputy Commissioner of the Social Security Administration. Welcome, Mr. Biggs.

Dean Baker is the co-director of the Center for Economic and Policy Research. He has published extensively on these issues and on the tax treatment of retirement benefits. He is one of the foremost experts in the field. His research is regularly cited in major media outlets. Mr. Baker, welcome.

And finally, John Sweeney is executive vice president of Fidelity. He is responsible for portfolio advisory services, where Fidelity has developed some of the best research available on America's retirement security. Thank you, Mr. Sweeney, for joining us.

Your written statements will be entered into the record. We appreciate you limiting your oral testimony to the allotted 5 minutes so we will have ample time for questions.

Mr. Romasco, please begin.

**STATEMENT OF ROB G. ROMASCO,  
PRESIDENT, AARP, WASHINGTON, DC**

Mr. ROMASCO. Chairman Brown, Ranking Member Toomey, Senator Casey, Senator Isakson, on behalf of AARP's more than 37 million members, we thank you for holding this hearing on Social Security's role as one of the Nation's most important family protection programs. My name is Rob Romasco. I am a member of AARP's all-volunteer board of directors, and I am honored to serve as AARP's president.

When we think about Social Security, we tend to picture retired people, and they are indeed the majority of those receiving benefits. That alone is a critical, important function. But Social Security is far more. It protects working men and women throughout their lives from the risks that can lead to the loss of livelihood, such as from death or disability. We may not think of Social Security as a family income protection program, but that is exactly what it is.

Picture this. More than 4 million Social Security recipients are children. In fact, Social Security pays more benefits to children than any other government program. Social Security coverage also protects more than 9 in 10 younger workers against the risks of death and disability, something that one in three workers will face before they retire.

Social Security is an insurance policy with benefits worth hundreds of thousands of dollars. Social Security is critically important for millions of children who live with their grandparents. Without these benefits, many grand-families would sink into poverty. It is disaster relief that is there for families when catastrophe strikes. Less than 3 weeks after the September 11 terrorist attack, the Social Security Administration sent the first checks to survivors of workers killed in New York, Virginia, and Pennsylvania. Today, eligible children and surviving spouses of people killed and disabled in the attacks are still receiving monthly benefits.

Picture for a moment, you are a 33-year-old mother of one, with a baby on the way, who learns her husband was just killed in an accident at work. Imagine that you have no idea how you are going to feed your family. Now, imagine the relief of discovering a program that will help you support your children until they become adults. That is a blessing—Social Security—and that family was mine.

My dad died before I was born. My mom worked incredibly hard as a seamstress. But Social Security benefits, survivor benefits, were a big help in putting food on the table, clothes on our backs, and a roof over our head. So, yes, Social Security is a genuine lifeline for families, for every generation. It is a lifeline embraced by the young as well as their elders.

As I travel across the country, people of all ages, especially those over 50, express their passionate commitment to leaving the world a better place for their children and grandchildren. As I visit college campuses, students talk about making sure their parents and grandparents are secure and independent. Social Security, the young and old understand, is a vital part of the intergenerational compact.

We hear sometimes that the young and old are rival armies in the struggle for finite resources. That is not what I see. I see family members who depend on each other. I see Americans at different stages in life's journey, older people helping younger people. Later, the caregivers become the cared for. One day, the young will need the retirement protections of Social Security every bit as much as seniors do today, and perhaps even more.

Social Security is one of the pillars of retirement security—that 3-legged stool Senator Brown talked about—we could once depend upon, along with the employer-provided pensions and personal savings. Unfortunately, Social Security is the sole remaining dependable leg.

Traditional defined employee-based pensions have gone the way of the floppy disk. Retirement savings have shrunk. Real wages for most Americans are stagnant or going down. Health care costs have soared. No wonder more than 1 in 3 working households from 21 to 64 years of age has no retirement savings. Half the workforce has no employer-provided retirement plan. For those who do, the

amount in their 401(k)s would pay them a retirement benefit of less than \$80 a month for life.

Financial security for many Americans is in jeopardy. Unless we reverse the current trends of stagnant wages and no pensions, Social Security will be even more important and, in many cases, the only source of retirement income for our families and our loved ones.

We have to make sure Social Security is strengthened as a critical source of income they can rely upon. We also must help the American public understand that Social Security is not just a critical piece of retirement security, but also a powerful engine in our economy. State and local economies, businesses, and workers benefit from every Social Security dollar paid out.

At AARP, we just did a report, which I would respectfully request be included in the record, that found each \$1 paid to beneficiaries generates nearly \$2 in spending by individuals and businesses, adding about \$1.4 trillion in total economic output in the year 2012. This output generates tax revenues for the State, local, and Federal governments exceeding \$220 billion.

The discussion the Nation needs to have about Social Security and retirement is more than about deficit numbers. It is about family protection and community support. It is about real families trying to make ends meet and afford the necessities of life. It is about children making sure their parents and grandparents can live with dignity and independently. It is about our parents not wanting to be a burden on their children. It is about my sister and me having enough to survive as children so we could change the trajectories of our lives and make a meaningful contribution.

Social Security belongs to the people who worked hard all their lives and contributed from every paycheck, the people who were promised that it would be there for them and their families. It is a critical part of protecting our families throughout our working lives. It belongs to the children and grandchildren whose lives have been touched by misfortune. It protects all our families today and in future generations. We are all in this together.

Thank you very much.

[The prepared statement of Mr. Romasco appears in the appendix.]

Senator BROWN. Thank you, Mr. Romasco.

Mr. Biggs?

**STATEMENT OF ANDREW G. BIGGS, RESIDENT SCHOLAR,  
AMERICAN ENTERPRISE INSTITUTE, WASHINGTON, DC**

Mr. BIGGS. Thank you very much, Chairman Brown, Ranking Member Toomey, members of the committee. Thank you for the opportunity to testify today with regard to Social Security, pensions, and the retirement security of the American people.

I wish to make three main points. First, Social Security's benefits are more adequate, but its financing less healthy than many suspect. Financial advisors generally recommend that retirees have an income equal to 70 to 80 percent of their pre-retirement earnings. The typical new retiree today receives a Social Security benefit equal to around 69 percent of their earnings immediately preceding retirement. Does this mean that retirees are living high on the hog

from Social Security? Of course not. And there are many low-income retirees who clearly receive inadequate benefits from the program.

But it is not clear that Social Security's benefits are all together too stingy. Yes, some European countries pay higher pension benefits than we do, but, if you look at countries with similar political and economic cultures to our own, say, the U.K., Canada, Australia, or New Zealand, their pension plans offer replacement rates that are pretty close to what Social Security pays.

But Social Security's finances are weaker than commonly understood. To make the program sustainably solvent without reducing benefits would demand an immediate and permanent 29-percent tax increase. If these tax increases are delayed, they only grow larger.

Some have been willing to propose such tax increases, in particular by eliminating the \$113,000 ceiling on which payroll taxes are levied. This seems like a tempting and an easy solution to the Social Security problems. But let me point out several downsides. First, eliminating the so-called tax max would raise the top tax rate on earned income from around 43 percent today to about 55 percent. Add State income taxes, and the top tax rate generally rises above 60 percent and, in some States, closer to 70 percent. Eliminating the so-called tax max would effectively tap out high earners before we fix the larger financial problems facing Medicare and Medicaid.

Also, current proposals to eliminate the tax max also would increase benefits. As a result, they would fix only around half the 75-year shortfall and extend solvency by around 16 years. Furthermore, in an international context, our tax max is not unusually low. In the U.S., payroll taxes are applied up to around 3 times the average wage. In the average OECD country, payroll taxes are capped at around twice the average wage.

The principal risk to retirement security today is Social Security's insolvency. I believe that talk of raising Social Security benefits before solvency is restored is irresponsible.

Second, some look with dismay at how defined contribution plans have supplanted traditional defined benefit plans over the past several decades, but participation in a traditional DB pension does not mean you will receive benefits from one. While long-term employees do very well from DB pensions, only around 1 in 10 individuals participating in DB systems actually ends up collecting benefits from them.

For instance, the average employee today changes jobs every 4.6 years. Such an employee would not even vest in a traditional defined benefit plan. And even employees who do vest often do not receive much. Despite our nostalgia for DB plans, I would wager that if DB pensions were the only plans available today, retirement security in the U.S. would be considerably worsened.

Finally, while DB pensions do have important advantages over DC pensions, which I outline in my written testimony, many of these advantages can be transferred to DC programs. For instance, consider a defined contribution pension plan which had automatic enrollment at a healthy contribution rate, invested in a life cycle portfolio which automatically shifted from stocks to bonds over

time, with investments composed of low-cost index funds, and that at least partially annuitized benefits at retirement.

Such a plan would address most of the concerns raised about retirement security today with very limited downsides for individuals and no risk to the taxpayer. Moreover, nearly all of this will be allowable under current law.

Retirement policy has massive ramifications for individual retirement security, the Federal budget, and the broader American economy. We need policies that encourage Americans to work and to save and to delay retirement. Such policies will enhance individual retirement security, as well as boost the economy, which is the ultimate source of retirement income for all of us.

Thank you for your consideration.

[The prepared statement of Mr. Biggs appears in the appendix.]

Senator BROWN. Thank you very much, Mr. Biggs.

Mr. Baker?

**STATEMENT OF DEAN BAKER, CO-DIRECTOR, CENTER FOR ECONOMIC AND POLICY RESEARCH, WASHINGTON, DC**

Mr. BAKER. Thank you very much, Chairman Brown, Ranking Member Toomey, for inviting me to speak here today.

I want to make three main points in my testimony, first off, emphasizing the comments Chairman Brown had made at the beginning that Social Security is the main source of income for most retirees, particularly moderate-income retirees; secondly, that it is projected to become an even more important source of income in the decades ahead, primarily as a result of the disappearance of defined benefit pension plans, inadequate replacement of 401(k)s, and also stagnant wages. Third, I want to comment briefly on proposals to change the indexation formula for Social Security. I would argue that switching to the elderly consumer price index is very much in keeping with the original intent of Congress, and I would argue the opposite with the chained consumer price index. That is basically a way to cut the program.

Before I do that, I just want to quickly make a couple of comments. Ranking Member Toomey had said that Social Security was cash-flow negative. I would like to point out that, in fact, that is not the case. A portion of the cash flow is interest on the bonds held by the trust fund. That is under the law. A business that had interest income would not be considered cash-flow negative if that put it into positive territory.

Another point that I just want to make quickly is in terms of the size of the tax increases. I think it is important to realize two points. One is the extent to which the shortfall facing Social Security is attributable to the upward redistribution of income over the last 3 decades. Ninety percent of wage income was covered by the cap after the Greenspan Commission set it in 1983. Because of a large upward redistribution of income, we now cover less than 83 percent of wage income. If it had covered 90 percent of wage income over this whole period, that would have cut the projected shortfall by more than 40 percent.

In the same vein, when we talk about the size of the tax increases, it is important to keep in mind some reference. We have seen stagnant wages over the last 3 decades for most workers. If

workers' wages grew at the same rate as projected average wage growth—in other words, all workers shared equally in wage growth—the tax increases needed to make the fund fully solvent would be about 5 percent of projected wage growth over the next 3 decades. And you are welcome to decide whether that is big or small, but I think it is important to understand the context.

Returning to the points I had wanted to make, Chairman Brown very well laid out the basic argument about how important Social Security is for most retirees. It covers 36 percent of income for people over age 65, and 52.2 percent of non-wage income. It provides 90 percent or more of the income for 35 percent of seniors and 45 percent of unmarried seniors.

One of the facts about seniors I think is very striking is that the poverty rate, the supplemental poverty rate, which most people view as the better measure for seniors, is now 14.8 percent. That compares to 15.5 percent for the adult population as a whole. The story there is that Social Security has been effective in lifting huge numbers of seniors above poverty. So their poverty rate is basically the same as the adult population, which is very different from the story we saw before we had Social Security.

The second point I wanted to make is the importance of Social Security for middle-income people, a population that is projected to rise hugely over the next 2 decades. If we look at the current generation of retirees, Social Security accounts for 34.2 percent of their total income. That is projected to rise to 37 percent for workers who hit 67 between the years 2033 and 2042. The rise is more dramatic if you look at non-wage income. It goes from 41.9 percent to 48.6 percent. If you look at non-wage, non-rental income—we have imputed housing income in that—the rise is from 46.4 percent to 54.8 percent.

This just illustrates the fact that, because of the collapse of defined benefit pensions, Social Security is projected to be a much more important source of income in the decades ahead, something that I think we all have to be very aware of.

The last point I want to make is in reference to the elderly consumer price index. If you go back to the decision to index Social Security to the cost of living, presumably Congress did that in 1975 with the intention of ensuring that seniors could preserve their standard of living. The elderly index is intended to track the standard of living—the prices paid by the elderly. It has consistently risen two-tenths to three-tenths of a percentage point more rapidly than the overall CPI, primarily because of the more rapid growth in health care costs.

By contrast, if we look at the proposal to switch the indexation to the chained consumer price index, there is literally no evidence—no one claims that that is a more accurate measure of the cost of living as seen by the elderly. There are features of that that are desirable, such as picking up substitution, but it is looking at substitution for the population as a whole, not for the elderly.

If the intention of Congress is to have an index that accurately tracks the consumption patterns of the elderly, it can instruct the Bureau of Labor Statistics to set one up. And frankly, I do not know whether that would show a higher measured rate of inflation

or a lower measured rate of inflation. What I can say is, it would show a more accurate one.

Thank you.

[The prepared statement of Mr. Baker appears in the appendix.]  
Senator BROWN. Thank you, Mr. Baker.

Mr. Sweeney?

**STATEMENT OF JOHN F. SWEENEY, EXECUTIVE VICE  
PRESIDENT, FIDELITY INVESTMENTS, BOSTON, MA**

Mr. SWEENEY. Chairman Brown, Ranking Member Toomey, Senators Isakson and Casey, thank you for having us speak to you today on this very important topic. My name is John Sweeney. I am an executive vice president at Fidelity Investments. I am responsible for the retirement and investment strategies that we develop for the investors that we serve.

We have the privilege of helping more than 23 million Americans save for retirement through their workplace and personal savings retirement accounts, such as 401(k)s and IRAs. And like you, we want to help Americans feel more confident, make clear financial decisions, and achieve better results for their families when it comes to retirement.

At Fidelity, we are passionate about sharing our expertise and our insights with our customers. Every day, working Americans ask us how to divide their family's paycheck in order to meet multiple financial obligations, including paying down a mortgage, saving for their children's college, possibly caring for an aging parent. One goal which is common to all of our customers is being ready for retirement. This includes the young investors enrolling in a workplace savings plan or an older couple nearing 65 and asking if they have saved enough to contemplate retirement.

These investors need help navigating the multiple accounts and investment choices available to them at all stages of life. We believe that the private retirement system is working well for those who utilize it as designed. However, many people are not saving enough to ensure that they will have a comfortable retirement, and young investors face an especially difficult road ahead. At the highest level, Americans need to save more, and we need to incent them to do that, and we need to provide the help that they are seeking in order to make it easier to achieve retirement security.

As you know, workplace savings plans have become one of the primary ways that most working Americans save for retirement. And for those who enroll early in their careers, save as much as possible, increase their savings as they earn more, and stay the course when markets get volatile, the results are generally good.

In fact, our latest data shows that for people who have been continuously saving for 10 years, the average balance in a 401(k) has reached more than \$223,000, up from approximately \$53,000 a decade ago, representing a more than 15-percent annual increase. That said, we still have work to do to ensure that as many people as possible are prepared for retirement.

We surveyed several thousand American households to understand how prepared people were to cover basic expenses like housing, food, and health care in retirement, and the results, in aggregate, were sobering. We found that 55 percent of American workers



were in fair or poor condition and were not on track to cover their essential expenses in retirement. We coded these people red and yellow in our retirement preparedness measure, which you will see on page 7 of our written testimony, as well as on the chart to my right.

On the other hand, a third of the households we surveyed are on track to cover 95 percent of essential expenses. We have given these people a green score, and, for these people, the system is working well. And, while baby boomers, as an age cohort, are generally doing well, Generation Y workers face more significant challenges. With longer life expectancies and fewer pensions available to them, Gen Y investors will need to save more on their own and anticipate working longer in order to live a comfortable retirement.

That is why we believe that we need to encourage higher levels of savings now. We know, especially with younger investors, that the most powerful way to improve readiness is to save more, even if only a small amount. Our research shows that for a 25-year-old earning \$40,000 a year, increasing savings just 1 percent a year can mean up to \$300 per month more in income in retirement.

We applaud the employers who have adopted auto-enrollment and auto-increase programs and provide a generous company match. These firms are leaders in helping their employees get on the path to retirement security.

Policymakers should consider doubling the default savings rate from 3 percent to 6 percent. While our research shows that people need to save 10 to 15 percent of their salary annually in order to retire securely, by starting at 6 percent with an auto-escalation feature, you can get a young saver on track to a successful retirement within a few short years. Taking this step now would mean a world of difference for younger generations in particular.

Finally, we need to continue to find ways to provide investors with more guidance and education, not less. At Fidelity, people come to us to help navigate some of the most complex, difficult decisions of their lives, and the demand for education and guidance is up dramatically since the financial crisis.

We take seriously our obligation to simplify that complexity and to do everything in our power to help them. The earlier, the better. Our data shows that workers who engage in a retirement planning session either online or on the phone increase the amount they save by an average of 5 to 6 percent. We take great pride in offering these resources to anyone.

We would encourage this committee to work with the administration to ensure that people can continue to have access to the kinds of resources they need to make good, responsible decisions for themselves and their families. We recognize there are major challenges to solving these issues, but, with your partnership, we can work together to increase the savings rates in the workplace and help more Americans be better prepared for retirement and meet the challenges that lie ahead.

So, thank you for the opportunity to appear today, and I am pleased to take your questions.

[The prepared statement of Mr. Sweeney appears in the appendix.]

Senator BROWN. Thank you, Mr. Sweeney.

Mr. Romasco, you suggested that some see efforts to enhance or increase Social Security in a variety of different ways as a war between the generations. Why are they wrong?

Mr. ROMASCO. I think the issue is, that is a false premise. Basically, it says we have a finite pot of resources, they are limited to these, and we have to fight over them.

The issue is, we all age. When you are 20 and you enter the workforce, you have, hopefully, a long life in retirement and so forth. And, if you look at the intergenerational activity, you are concerned about your life and your family and your parents and your grandparents, and vice versa.

So the notion is not one of intergenerational conflict. It should be intergenerational solidarity. If we look at the data, that data does not indicate the transfer of wealth from old to young. It is kind of different. It is from bottom to top. We have seen the most massive wealth redistribution in this country over the last 30 years.

So it is a false premise. We are all in this together. We care for our children. Our children do not want our parents to be burdened, and we, as grandparents and parents, do not want our children to be burdened. So, when you look at the intergenerational dynamics of families, of protecting them as workers, we have an idea based on social insurance. We are all in this together, we all contribute, and we take the benefits appropriately.

But they are designed to protect us all through the journey of life.

Senator BROWN. Thank you.

Mr. Biggs, I want to put a series of questions to you and then—I will just ask three or four questions—if you would answer them sort of together, and then each of you take a shot at that, if you would like to.

Just give us your general thoughts on, are current Social Security levels adequate? Should we enhance Social Security, and, if so, how should we do it? And, if you believe that we should modernize Social Security, what is your definition of modernizing the system?

Mr. Biggs, give us sort of your general thoughts about those three questions, and then each of you respond also, please.

Mr. BIGGS. Well, as I note in my testimony, I believe that Social Security benefits are, on average, more adequate than many people think. The talking point you hear, which comes from Social Security itself, says, well, financial advisors recommend you need to replace 70 percent to 80 percent of your retirement income. Social Security offers the average retiree 40 percent.

The problem is, those measurements are measured in different ways. Financial advisors measure benefits for replacement rates relative to final earnings. Social Security measures them relative to the wage-indexed average of your highest 35 earnings—do not worry how that is measured, but they are just apples and oranges.

If you measure Social Security benefits the way financial advisors would, relative to the earnings right before retirement, Social Security benefits, on average, are not, clearly, inadequate.

At the same time, the big problem for folks at the low end is not that Social Security benefits are not adequate, on average, or that Social Security benefits are not progressive enough. The problem is

that there is an enormous variation in the replacement rates that people receive even if they have the same lifetime incomes and the same contributions to the program.

For example, if you take a husband and wife, a couple, the benefit they can get can vary based on whether they split the earnings evenly between the husband and wife or whether the husband earns it all and the wife does not, even if they have the exact same lifetime earnings. Likewise, if you have two individuals with the same total lifetime earnings, and one fits them into 35 years, but the other has a longer career, over 45 years, they will have the same lifetime earnings, but they will get a very different benefit.

For low-income people, Social Security is a risky benefit, not in the sense of market risk, but it is an uncertain benefit, highly uncertain. You have enormous variation in the benefits they receive. If we simply reduce that variation and give a better-targeted, more uniform benefit, which is something I have written about fairly extensively, you could reduce poverty in old age, you could provide a much more reliable social insurance program, and you could do it at the same price that we are currently paying.

The problem with Social Security is, as a social insurance program, it is like a housing insurance policy that may or may not pay off if your house burns down. You cannot be assured of having a high replacement rate if you are a low-income person.

So I think we need a simpler, better-targeted program, one that is a better social insurance policy for people on the bottom end, but, to be frank, tells middle- and high-income people they have to save more.

People know—and Dean’s testimony will point to this—that Social Security is an important component of income even for middle-income and even high-income people in the United States. Some people will say, well, that shows how important Social Security is. What that tells me is we have a lot of people who could, should, and would be saving more, but they are not because they are getting Social Security benefits instead.

Low-income people need a better Social Security program, but higher-income folks really do need to save more on their own.

Senator BROWN. Mr. Baker, your thoughts on those questions?

Mr. BAKER. A couple of points. I would say, certainly for low-income to moderate-income people, I think Social Security is inadequate. And sort of the good part of that story is, it is easy to make a very big difference for low- and moderate-income people with some reforms that do not add a lot to the cost.

Some women’s groups put together a program some years back that called for, among other things, making the surviving spousal benefit 75 percent of the combined benefit. A lot of the poorest elderly are surviving spouses, most often women, obviously, in their 80s and 90s and older years. It is a relatively low-cost proposal. You could cap that at the average wage so it does not add a big expense.

Also, raising the bottom tier from 90 percent to 100 percent, you could take that back so that higher-income beneficiaries do not benefit from that. Again, that would limit the cost and increase the payback of the benefits on the order of 11 percent for lower-income

people. So I think there are some things we could do at very low cost.

Now, I think I am agreeing here with Andrew a little bit. I do think it is important to make it easier for people to save, and I think that it is unfortunate that so many workers, basically, have lost defined benefit pension plans, and many workers do not work at places that have defined contribution plans, or, if they do, they do not stay there long enough.

There have been a number of proposals, and I think some of them have enjoyed bipartisan support, to set up some sort of system, like the Thrift Savings Plan, that would be open to everyone, an affordable system, a low-cost system. The administrative costs, of course, make a very big difference. Mr. Sweeney's outfit does have very low costs. Many do not. Those low costs make a very big difference in someone's ability to accumulate wealth for retirement.

So, if everyone had the option to have a certain amount deducted—and you could have that as a default contribution you could opt out of—and put into a Thrift Savings-type plan with low administrative costs, take that wherever they went, automatic annuitization, again, opt out of that, but that would be the default, I think that could make a big difference for middle-income retirees and how much they are able to save.

Senator BROWN. Mr. Sweeney, your thoughts on that?

Mr. SWEENEY. Chairman Brown, the way we think about Social Security is, it solves two issues: one, longevity, and two, it provides a floor of predictable income for people who are entering retirement.

So, when we do retirement planning with customers who are contemplating the ability to enter retirement, we ask them to figure out their expenses, and really what we are trying to do is cover those essential expenses—food, shelter, medical care—with as predictable a stream of income as possible. Social Security provides one of those predictable streams of income.

The other thing, though, that we do counsel them is, if you can continue to work longer, the benefit you will receive on an annual basis increases approximately 8 percent a year. So that is one of the tradeoffs.

We ask people who have accumulated some wealth to think about spending down their current personal wealth before they tap into Social Security in order to receive a higher annual payment from Social Security if they can defer the time they begin taking it.

Senator BROWN. Thank you.

Senator Toomey?

Senator TOOMEY. Thanks, Mr. Chairman.

I want to delve into the solvency issue facing Social Security. And Mr. Baker objected to my characterizing the program as being cash-flow negative, and, of course, technically, he is exactly correct, because we have what I consider a series of accounting devices that obfuscate the reality of this program.

One of them is the interest income that is a certificate that the Treasury hands over to the Social Security Administration, which is promptly filed in a filing cabinet and has no more real assets behind it than any of the certificates in that filing cabinet.

So, when we look at this, we could look narrowly at what we deem to be assets in the Social Security Trust Fund, and I think we would miss the more essential point, which is this: what is the ability of the Federal Government to honor the commitments that it has made to current retirees and future retirees in the Social Security program?

Mr. Biggs, I am wondering if you would agree with my characterization that, for the purpose of evaluating that question—the ability of the Federal Government, as a whole, to actually honor its commitments—what matters is the cash flow that is coming in through the payroll taxes and the benefits that are being paid out, and intra-governmental transfers of certificates do not have any material impact at all on that fundamental ability.

Do you agree with that, Mr. Biggs?

Mr. BIGGS. Sure. I mean, here is maybe one way to think about it. Imagine if we had no Social Security Trust Fund at all. If that were the case, then back a couple of years ago when Social Security started running negative cash flow, we would face the choice of either raising taxes, issuing more debt, or cutting benefits. So those would be the three choices we would face.

When you do have a trust fund, you have essentially the three same choices. The trust fund biases you in one direction. As long as you have a positive trust fund balance, the default position of the Federal Government is, well, we are either going to raise taxes or borrow so we can pay full benefits. Once the trust fund runs out, the default position of the Federal Government is, well, we are going to cut benefits back to whatever level we can pay with payroll taxes. So the trust fund has a legal significance, and it pushes your policy in one direction or the other, but the choices you face—the resources you have available, where you have to get them from—those are the same whether you have a trust fund or do not have a trust fund.

Senator TOOMEY. So is it fair to say that, economically, there are no real assets backing up the certificates in the trust fund and the existence of the trust fund does not have any impact whatsoever on the overall ability of the Federal Government to honor its commitments?

Mr. BIGGS. Exactly. The trust fund is a commitment to pay. It is not money that enables you to pay.

Senator TOOMEY. Right.

Mr. BIGGS. The trust fund does not make it any easier for taxpayers to finance Social Security. It just says that the taxpayer has promised to finance Social Security.

Senator TOOMEY. And this interest income, which I would view as an accounting device, is that not rather akin to my taking \$1,000 out of my savings account, moving it to my checking account and saying, oh, I have another \$1,000 of income? There is nothing real there.

I think it is important that we focus on this, because I think we are kidding ourselves if we think that somehow everything is fine for several decades because we have this nominal trust fund that we treat as though it were real assets, and it is fundamentally not.

I want to ask another question, because you made a very interesting series of points about how defined contribution plans could

have the advantages that we often associate with defined benefit plans. I think people sometimes mistakenly think of or even characterize defined contribution plans as being very risky, and they think of the person who takes their accumulated life savings and invests in Enron the day before it all goes to nothing.

But life cycle investing and at least partial annuitization eliminate that risk. Could you explain in particular what the life cycle investment profile is all about and how that works?

Mr. BIGGS. Well, you get these life cycle—some people call them lifestyle—funds. They are available in the Thrift Savings Plan today. They are available in a number of 401(k) plans. And they try to tackle the problem that a lot of people do not pay very much attention to their investments. People do not reallocate their investments as they get older. They do not think about how their different investments fared.

So these are plans that automatically shift you from stocks when you are young to bonds as you get older. The idea is that, when you are younger, you can afford to bear a little bit more investment risk. When you are older, you want something that is more predictable. And it does this automatically over time. If you have this allocation working, as the TSP does, using low-cost index funds, it is a simple and low-cost solution to a problem.

I think, just more broadly, when people think about DB versus DC plans, the thing they think about is, who bears the market risk? I think that is actually the less important thing to focus on. But the difference of being automatically enrolled, the difference in the contribution rates or the saving rates, the difference in terms of annuitization, those are, by far, the more important differences to me, and those are things we can do today through DC plans and, to a certain degree, we already are doing today.

DC plans clearly have problems. I do not deny that. But they are problems that could be fixed. DB plans, again, if you look at the State and local sector, have problems that I think, in a lot of ways, are much, much more difficult to fix.

Senator TOOMEY. Thanks very much. I see my time has expired. Thanks, Mr. Chairman.

Senator BROWN. Sure.

Senator Isakson?

Senator ISAKSON. In 1983, when Reagan and O'Neill, Tip O'Neill, changed the Social Security rules, I was 39 years old, and they passed a new rule that said if you were born after 1943, your eligibility went from age 65 to age 66. Well, I was born in 1944, so I was the first generation of Americans to lose a year of my Social Security eligibility. And it is going to age 67 here in a few years.

There are a lot of people proposing looking into the out-years and pushing eligibility out in the out-years for our children and grandchildren. What would be your position on that, Mr. Romasco?

Mr. ROMASCO. Well, I think what we have advocated and have been strenuously advocating for over a year is, let us take this conversation out of the deficit discussion and have a retirement discussion. And among the possibilities is raising the age, along with a series of others. But we have to look at the financial issue, the circumstantial issue, as well as sort of the value issue.

I think there are challenges with raising the age, and I think one of the challenges is, clearly, it is going to become very difficult to ask a coal miner to go down in that mine when he is 68 or 69 or 70 or a waitress who has been on her feet for 30 years.

So I think there are issues with it, and I think that should be part of that larger conversation about Social Security's role in the broader retirement system. We have heard a lot of suggestions here that are worthy of consideration, but the important thing is, let us have Social Security as part of our retirement system conversation, not a deficit conversation.

Senator ISAKSON. Mr. Biggs, what do you think about raising the age? Just briefly.

Mr. BIGGS. Well, Mr. Romasco cited a coal miner or somebody like that. Go back to 1950 when we had a highly industrialized economy. You had coal miners and farmers and factory workers. The average age of initial Social Security claiming then was 68. Today, when your biggest on-the-job risk is carpal tunnel syndrome from your mouse or something like that, it is 63.

In a proposal I did for AEI a few months ago, I did not propose raising the retirement age. But I think the idea that we cannot have a higher retirement age, I think it just flies in the face of the fact that people did, in fact, retire later in the past, and today's jobs are less physically demanding than they were in the past.

So it is not something I say has to happen, but I think it is something that people should at least be open to.

Senator ISAKSON. Mr. Baker?

Mr. BAKER. Well, just a couple of points. First off, there has been a growing gap in life expectancy. So people often point to the fact that we are living longer, and that is true, but it is not quite the same for everyone. So, disproportionately, the gains in life expectancy have gone to those in the top quintile, not to those in the bottom half of the income distribution. So the idea that they will enjoy a longer retirement is not necessarily true.

The other point is, following on Andrew's, we actually did an analysis of this, looking at Labor Department classifications, and we found that close to half of workers and close to 60 percent of workers in the bottom quintile were at jobs that were classified by the Labor Department as physically demanding. So these are people working as custodians, working as waitresses, being on their feet pretty much 8 hours a day.

So the idea that we are all just worried about carpal tunnel syndrome with our mouse, I think that is just not true. So I would be very hesitant to raise the retirement age.

Senator ISAKSON. Mr. Sweeney?

Mr. SWEENEY. Senator Isakson, we actually tried to quantify in our survey how impactful delaying retirement was. We found that if workers delayed retirement from 65 to age 70, they saw a 12-point improvement in what we characterized as their retirement preparedness measure. When we saw folks who worked part-time—that was working 1 day less a week for each of those 5 years past age 65—we saw a 7-point improvement in their scores. So it is a choice that people can make.

The other thing I would say about the types of work that people do is, we are going to have seven different jobs during the course

of our working tenure, and so those jobs may not all be the same types of jobs. We just need to consider what type of work people want to do.

People want to work longer. Today's 65-year-olds are more healthy and more active than our parents' generation. So I think that is going to be a trend that workers are going to want to continue to pursue.

Senator ISAKSON. One of the things that I think is probably the single biggest problem we have to figure a way to overcome is the lack of investor sophistication and knowledge of the average American in terms of saving for their retirement in the first place.

I know at Fidelity, you deal with that probably every day. When they come in at age 55, saying, "Well, I think I want to retire in 10 years, can you help me get ready," if they had done that 25 years earlier, it would have been a lot easier question.

I have a resolution—I think Senator Toomey has signed onto it and some of the others—to really promote the tax benefits of retirement savings and government programs that incentivize people to save. Are there things that you all can recommend that we should be doing? Because, in the end, the easing of the pressure on the government is going to be when individuals are capable of taking better care of themselves because they are better educated on the compounding of interest and retirement security in the first place.

Mr. SWEENEY. Exactly right. The younger we can get an employee engaged in saving at a high level, correctly allocated, and understanding that they should continue to save even when markets get volatile, the more likely we are going to be successful in the future, and people are going to be better prepared to enter retirement.

Some of the comments that Mr. Biggs made about auto-enrollment—we have seen that to be very successful. Seventy-five percent of the plans that we administer offer auto-enrollment, but we need to have more employers make that a mandatory option.

The other feature that is advantageous is what we call auto-escalation. So today people default in at a 3-percent enrollment rate; 3 percent of their salary gets deferred to their 401(k). We think that number should be doubled to 6 percent.

The real target is a number between 10 and 15 percent, which includes the employee contributions, plus a match, where available, from the employer. We want the auto-escalation so that people, over a very short period of time, get to that target savings rate of 10 to 15 percent.

Senator BROWN. Senator Casey?

Senator CASEY. Mr. Chairman, thank you very much. And I want to thank Senator Brown for calling the hearing and for the work that he and Senator Toomey did to bring this hearing about.

I want to start with Mr. Romasco. And I had a couple of questions prepared, but your opening statement, the way you personalized it sometimes, is the kind of testimony that we do not hear too often in this room.

I want you to, if you could—and I know your answer probably is dependent upon some bit of extrapolation maybe, but if you could project to the present that scenario that you described that your mom was facing. How do you compare what your mom was facing



in terms of the dependency on Social Security and the effectiveness of it with what a 33-year-old mother would face today who loses her husband and has one child and one on the way? Are you able to do that?

Mr. ROMASCO. Well, it is hard to do that, but I can tell you that if we look at the circumstances, if that were happening today, I suspect she would have twice as much difficulty finding a job, keeping a job, and paying the rent. It was a three-decker house in a working class suburb of Boston, part of Boston, and the forces, the economic forces in the late 1940s and early 1950s, were not lavish, but they are more severe now. Health care costs have increased. The utilities—all the costs have increased tremendously. So I would suspect it would be even more challenging, particularly given what has happened with wages over time. So I am just projecting that.

And the difference of having some level of security, to know that we can pay the rent, we can put food on the table, makes an enormous difference in the way the family unit stays together. And I did not realize it, frankly, until I started to look into it. I always assumed my life was fine. I did not sit at the table with my mom and do the bills. But I had a sense of security, and I knew that I had a vague notion that a check was coming and she was not pulling her hair out every night. She was working hard. I suspect that would be significantly different.

Remember, 20 percent of us in this country are doing okay, especially in this zip code. One percent of us are doing really okay. But most members tell me, "Rob, I'm just trying to get to Friday." I am really worried about all Americans, particularly the 80 percent of us who are just trying to get to Friday.

Senator CASEY. And I do not think there is any question that you do not need to have a degree in economics or a lot of advanced learning to look at the data on what has happened to the middle class over the last 4 years, the last 10 years, or the last 45. It is just stunning, the hammer blows that the middle class has endured—and the folks who are just below the middle class.

You talked about, in your testimony, the idea that Social Security has become the primary source of retirement income, and you also point out that 78 million Americans do not have access to a workplace retirement plan. That is a really stunning number.

We can debate how that has happened, but what would you hope that the Congress would do in just say the next 2 years or so, if we had an opportunity to make changes? Because I think all of us in either party, as much as we debate and might have disagreements, I think we all have a pretty serious obligation to get this right.

I just want to get your thoughts on what you hope we would do.

Mr. ROMASCO. Well, the first thing is, let us make sure we do not conflate this conversation with the deficit conversation. Let us have a separate conversation. This is a real challenge, the retirement challenge. Social Security plays a huge role in that.

But I think we have heard a lot of suggestions about how to look at work and savings as part of the 3-legged stool. How do we restore that, those two legs, and not decimate or weaken Social Security? Remember, Social Security is about adequacy, as well as sol-

vency, and I thought we heard a number of suggestions today that should be part of that conversation that can strengthen the savings dimension of that and encourage that.

But at the same time, let us not look at Social Security as a piggy bank to solve the deficit. Let us have a separate conversation about that, and then ask the fundamental question, what kind of country do we want? What can we afford, and what are we willing to pay for?

Senator CASEY. Mr. Chairman, I know the red light is on, but, because we are in a smaller hearing, I am asking your indulgence.

Maybe we could just do a lightning round with the remaining witnesses on what you would hope we would do in the next 2 years. We will not allow you to have much time, but you can encapsulate what you hope we would do.

Mr. BIGGS. Well, I agree that we would want to think about Social Security reform in a comprehensive way, in a far-reaching way. It is not simply about solvency.

Too often, the problem is that Republicans think that Social Security is doing fine, except we do not want to raise taxes. Democrats think Social Security is doing just fine, except we do not want to cut benefits.

The problem, but also the opportunity, is that Social Security is doing a lot of things not very well. If you make it do those things better, you can get a more efficient and more effective system.

A second quick point. Although I think you want to look comprehensively at Social Security, if you look at it in isolation of the rest of the budget, you are going to miss something. The question I would pose is: would you fix Social Security differently if we did not have huge deficits in Medicare and Medicaid? I think, pretty obviously, the answer to that is "yes." You would be more open to revenues perhaps than you would be if you did not have the Medicare problem.

So you have to think about all of this stuff together. You have to say, how do we make these things fit? Social Security seems to be something where we can ask middle- and upper-class people to do more to save on their own. In Medicare, it is a lot harder to do that. You cannot tell somebody to go pay for their own health care benefits, because it is an insurance program.

So we have to think about this in an integrated way as well.

Senator CASEY. Mr. Baker?

Mr. BAKER. I guess I would say a couple of things. First off, something that is defensible that could be done quickly is raising benefits for those at the bottom. I think you could make a very big difference in the income of a lot of retirees today or new retirees, raising those benefits at a relatively low cost.

In terms of how we think about the longer-range story, I think it is not just the budget. I would say it is the economy. Again, I was making this point earlier. Much of the shortfall that we are looking at in Social Security is because of the upward redistribution of wage income. That is a tragedy, and one aspect of that is, Social Security faces a more difficult situation. On the other hand, the good side of that is, that is money for people who would not otherwise have it and desperately need it.

So I think we have to hope for better economic outcomes. That is where my focus is. It is not just the budget. It is the economy. And also, getting back to the issues Andrew raises, Medicare and Medicaid, we have had a sharp slowdown in health care costs. That is really, really important. It is amazing how little that seems to be appreciated, because that has made more differences in deficit projections than I think anything Congress is likely to do in the next few years.

So let us hope that continues. I do not know whether it will or whether it will not, but that certainly affects the environment of how we think about Social Security or the government's liabilities in the long term.

Senator CASEY. Mr. Sweeney?

Mr. SWEENEY. Senator Casey, there are two things that I would suggest. One is, increasing financial education and guidance; so, making the ability to help people make quick decisions and make complex decisions simple, that is the first thing.

The second thing I would say is, from a behavioral decision-making standpoint, the auto features that were discussed earlier are actually very beneficial, improving upon those, because they are proven to work when used effectively. Auto-enrollment, auto-escalation of contributing at higher levels, and then the default enrollment in target-date funds—all three features have been shown to yield very strong results.

Senator CASEY. Thanks very much, Mr. Chairman.

Senator BROWN. Senator Wyden?

Senator WYDEN. Thank you, Senator Brown. I commend you for scheduling a very important hearing on a topic that really gets short shrift, and I commend you for it.

Gentlemen, I am struck by how many folks come up and describe accounts that invariably get into the question of their pension melting away. They are talking about hopes and dreams that they had had for years essentially evaporating because their pension is not going to be there. Of course, there are a lot of pieces to this puzzle, and the recession is a factor, the aging workforce is a factor. Certainly, it is hard to follow how some of the changes at the State level affect private pensions. There are a host of issues that go into this mix.

But I am also struck by some of the reports that some in the private sector—businesses and those in the retirement industry—seem to be doing some wheeling and dealing with pension funds. We recently came across the work of a *Wall Street Journal* reporter, Ellen Schultz, who apparently has done a fair amount of writing on this. She says—and she is not talking about all the businesses and all the people in the retirement industry, but she is saying that there are some who have taken billions of dollars from pension funds to finance downsizings and have sold the assets in merger deals.

They have talked about how there are loopholes in discrimination rules that permit pension plans to be capped to pay, in effect, for executive payment arrangements, executive parachutes, things of that nature. They talk about the exploitation of new accounting rules which create an incentive to cut benefits, and cut benefits

even when there was a pretty good argument that the pension had enough money.

And I was struck by this account, and clearly this reporter, a distinguished reporter, is not saying this is every business or everyone in the retirement industry. But I would be interested—and we can start with you, Mr. Baker, and you, Mr. Biggs, because you all have been in the field—how serious is this problem of the siphoning of dollars from pension funds to finance downsizing, the kind of wheeling and dealing that Ms. Schultz describes in really specific kinds of instances.

Is this a serious part of this, and, if so, what kind of enforcement efforts could be put in place to deal with this, because this really looks to me like it is way over the line and, if not looting of private pension funds, certainly is pretty serious financial misconduct that should not be tolerated?

Let's start with you, Mr. Baker, and then you, Mr. Biggs. How serious a problem are these issues?

Mr. Baker?

Mr. BAKER. Well, I do think it is a very serious problem. Just to be clear, I do not think that that explains much of the issue in terms of workers facing inadequate retirement, in large part, just because there are not that many workers who still have defined benefit pensions. But you certainly have a number of instances, which she documents, where certainly people are violating the intent of the law; whether they are violating the letter of the law, I cannot really speak to. But clearly, the intent of the law is that, once money is in a pension, it is supposed to stay in a pension. It is used for those workers' retirement. And she gives several accounts of ways in which major companies were able to effectively pull money out of those pensions in order to finance a merger or finance downsizing, whatever you want to say. And that should not happen.

So that requires greater policing, greater scrutiny, and probably greater penalties so that, when you can determine that someone has, in fact, violated the law, that it is not just a slap on the wrist. So, you want to play a game and see if you can get away with it? Well, you might risk some time in jail. I think that would make people more reluctant to do so.

Senator WYDEN. Let us have your colleague get into this. Mr. Biggs?

Mr. BIGGS. One of the problems with defined benefit pensions, which I did not mention in my testimony, is it is very easy for a plan sponsor to not do the right thing. It is easy to promise benefits, but nobody wants to pay for them. That is true in the corporate sector, and it is true in the State and local sector.

Defined benefit plans are very complex. They require a whole range of assumptions regarding what is going to go on in the future to determine what you have to pay today. It is very easy to avoid doing the right thing. A defined contribution plan is much more transparent. If your employer says, "I am going to put X amount into your 401(k) this year," they either put X in or they do not put X in. The monitoring is much easier.

That does not say there are not similar problems in 401(k)s. There was a recent case, I believe it was *International Paper*,

where they were accused of essentially funneling employee contributions into a fund of their own stock that charged them too much. That sort of thing can happen, and I think it should be punished. But by and large, I think it is not a major explanatory factor in problems we have in retirement security today, for the reasons Dean mentioned.

Senator WYDEN. Let us do this. And I asked it the way I did because this, to me, really is not what is useful about what Senator Brown and Senator Casey are trying to do. This is the kind of fact-finding effort that we ought to be doing more of.

Ms. Schultz is an award-winning journalist. She is not saying that this is going on at every company plan or every part of the retirement industry, but suffice it to say, if you have the kind of documented examples here and you do not have enforcement against those kinds of instances, that certainly is an invitation to others to try to skirt the rules.

Mr. Baker, have you or any of those who have been advocating for workers done some writing on suggestions with respect to penalties and consumer protections for workers that ought to be put in place?

Mr. BAKER. I have not written directly on this particular issue, but I can say that I would imagine others have. I just have to say I am not familiar with it. But I do have to say I kind of look at this as part of a sort of malfeasance, I think, in many cases, probably criminal actions that were taken as part of the financial crisis, and, as we know, almost no one has gone to jail in connection with that. And I do think that raises a serious issue.

It is not, one, just a punishment. We might want that, but more importantly, the question of incentives for people who think that they could violate the law and, at very worst, their company faces a modest fine, are not discouraging that behavior. And we seem to understand that in other contexts. I do not quite understand why we do not apply that financially.

Senator WYDEN. I am way over my time. Senator Brown, thank you. I would be open to suggestions from either of you two and from other panel members, because it struck me as an important set of issues that ought to be part of this debate.

You go to a conference, you go to some academic setting, and people talk to you about the recession, they talk to you about the aging workforce. Then you see people at a town hall meeting and they talk about their pension melting away and they have questions about how that happened, and I think we ought to be looking at some of those issues.

Thank you, Senator Brown. I thank you for your good work.

Senator BROWN. Thank you, Senator Wyden.

Senator Nelson?

Senator NELSON. Mr. Chairman, there is nothing better at focusing the mind than when you realize that you are facing a situation, and a lot of Americans do not face the fact of retirement until they are way on down the road.

The question is: are we going to have enough money in retirement? Have we saved enough? Several of us are sponsoring the Lifetime Income Disclosure Act, and it is a way of showing people

what their savings would look like in retirement as a way to get them to save more money today for retirement.

So I want to ask Mr. Sweeney, can you explain the innovative tools that Fidelity has in order to show your clients what their savings will look like at retirement and what else you think you need from the government to get people thinking about this so that they can adequately plan for retirement?

Mr. SWEENEY. Thank you, Senator Nelson. I would say two things. We develop a lot of tools that we make available to customers who work with Fidelity, but also to the general public. They can go in and they can assess their holdings with Fidelity. We also allow them to aggregate holdings that are kept at other firms.

We think that is important, because oftentimes we find two halves of a couple come in, one may have a plan that is record-kept at a Fidelity platform, one may have a plan that is record-kept at another firm, but both halves of a couple are gearing towards a common retirement, and they want to be able to see how their combined balances can be used to achieve those very goals.

We recently conducted what we call the retirement preparedness measure and calculated the readiness of people to do exactly what you say: take the accumulated assets and translate that into an income stream that will generate lifetime income.

So that is an important disclosure. We are doing a lot to try to educate investors. They come to us with complex problems. Our job is to try to simplify those problems. But I think that the most critical factor is increasing savings rates, particularly for young investors.

As they live longer, as they are less covered under pensions in the future, we think that they are going to have to save more on their own. So the more we can do to get them to save, and the more we can help people with comprehensive education, the more we are going to have an America that is better prepared for retirement in the future.

Senator NELSON. What are the savings rates of America compared to other industrialized countries?

Mr. SWEENEY. We look across the globe, and we look at different retirement systems. So, for example, Australia has a mandated retirement system which people are forced to put into a private retirement system of their choice. The thing that is perhaps masked is, they also have higher debt rates. We are not sure there is a causation there, but there seems to be some correlation.

So, when we look across the globe, we think that there is an opportunity for people at all income levels to take some money aside and save. It is a very difficult decision for a young worker who is trying to put money in their first 401(k), and they say, "How could I possibly save 10 percent?" The comment I give back to them is, I say, "If I offered you your same job at 90 cents on the dollar, would you still take the job?" They say, "Well, yes, I would figure out how to buy a less expensive apartment, drive my car a little bit longer. I would make some tradeoffs." But they would figure out how to live on 90 cents on the dollar. So that is really the decision we are asking each investor to make.

Senator NELSON. And your particular tools, other than aggregating all of their savings so they have a comprehensive view, what

do they basically do? You take their composite savings and then project at their retirement age how much that is going to give them each year for the actuarial length of their life? Is that what it is?

Mr. SWEENEY. We have several different tools. I can simplify them into accumulation-oriented tools and distribution-oriented tools. We have planning tools, and then we have investment tools.

So, if you think at the simplest level about accumulation, I want to make sure I am saving enough so that I have accumulated a nest egg, so when I reach retirement age, I am able to translate that into an income stream. Clearly, for a 25-year-old or a 45-year-old, they are much more focused on accumulation. That is the dialogue we have with them.

For a 65-year-old, it is much more about managing expenses. So we start with the expense hurdle that each retiree has to clear and look at the accumulated benefits that they have, either through their DC, their defined benefit program, or Social Security, and we say, how can you clear your monthly hurdle each month? But we do want to plan well beyond the actuarial life stage for retirees.

We find that one quarter of all couples will live into their early 90s, so planning to 87 is planning for a quarter of our population to fail.

Senator NELSON. Let me just take a pure hypothetical: a person who is retiring at age 65 who has a salary in the range of \$150,000. See if you can interpolate this for me. What basically is the nest egg of savings that they need to take them into their average situation of lifetime expectancy?

Mr. SWEENEY. We look at starting with an accumulated nest egg of about 8 to 10 times their salary. So somebody making \$150,000 at age 65, you would want them to be somewhere in the range of \$1.25 to \$1.5 million. It is a pretty substantial number.

Senator NELSON. And then that would pay out both principal plus interest over that actuarial life.

Mr. SWEENEY. Correct. But what we find is that, for customers at the higher earning levels, those hurdles that they need to clear when they get to retirement are not as high for those people, for a couple of reasons. First, we assume that people at those higher income levels—and we see this—are actually saving.

So, if I am saving 10 to 15 percent of my salary before I retire, automatically, I only need to clear a hurdle that is 85 cents on that dollar, because I no longer need to save for retirement. If I paid off my mortgage, that is, again, another big nut that you do not have to clear when you get to retirement. So you can begin to see what we call income replacement rates close to retirement ranging between 68 cents on the dollar for wealthier people up to ranges in the 90s for people who are at lower income levels.

Senator NELSON. Thank you very much. You directly answered what I wanted to find out. Thank you.

Thank you, Mr. Chairman.

Senator BROWN. That is the purpose of the hearing, Senator Nelson.

Senator NELSON. Thank you. Well, we have a lot of witnesses in front of us who do not answer.

Senator BROWN. I understand that. This is very good panel. Thank you, Senator Nelson. And we will do a second round of questions, Senator Casey.

I appreciated Senator Casey's comments, Mr. Romasco, about your personal story. I would like to kind of bring back the issue of retirement age and paint a picture of a couple of stories that are not as personal for me as they were for you, Mr. Romasco, but people whom I have gotten to know.

One was my neighbor—10 years ago, in a working-class city on Lake Erie, in Lorain, OH—who lived next door. I was then in my late 40s, early 50s. He was about my age. He had been a carpenter since he was 18, a non-union carpenter. So his retirement was not as organized and lucrative—lucrative is the wrong word—but not as generous as it would have been had he been a union carpenter.

But nonetheless, he had worked for 30 years, and there were a lot of things he could no longer do. I mean, he had trouble lifting things. He had worked outside. If you live on Lake Erie, it is pretty cold working outside on construction projects. He was doing pretty well with his income, but his body was breaking down.

The second story is, I was in Youngstown at a town hall. A woman put her hand up. She struck me as someone—she said, "I have worked all my life. Now I am working two jobs. I am 63 years old." And then she said, "I've just got to live another year and a half so I can get health care."

I mean, imagine someone thinking in their life that their goal—she had no insurance, and I do not think she had been insured much of her life. Her goal was to be able to live long enough to get health care, not live long enough to see a grandchild, not live long enough to complete something, some hobby or workplace success or something, but just to get health insurance. I mean, I think when we think about retirement age, I think we need to think in terms of personalizing it in that sense.

But here is what I want to ask about. We know about the gap in life expectancy for those two people I mentioned—I, obviously, do not know about their personal life expectancy nor do they, but on the average, they will not live nearly as long as those of us who dress this way and have jobs like we have will live, on the average. We know that.

We know that those same people, those two people, what they represent are much less likely than the seven of us to have, not just the leg on the stool of Social Security, but also have some other kind of private pension, private or public pension, and some significant savings.

And we also know a third thing, and that is the increase in jobs in this country, the growth in jobs, is mostly in low-income areas. It is fast food workers, it is health care workers, people who often do not have insurance. They will have health care, fortunately, now, because of the ACA, most of them, but they also are unlikely to save. They are unlikely to have any kind of employer pension, or, if they do, it will not be particularly lucrative.

So with all of that, we are seeing people like Simpson-Bowles saying, raise the retirement age. We are seeing all the serious people in Washington on the talk shows say we should raise the retirement age.



Talk that through, not just your position on retirement age—you have pretty much made that point—but what do we do about people who are retiring, people who are low-income, who do not live as long, people who do not draw as much Social Security, and people who live longer and have had more comfortable lives in terms of dollars who are living longer and getting higher Social Security?

How do we deal with this in light of low-income workers generally?

Mr. Romasco, do you want to start with that?

Mr. ROMASCO. Well I think, first of all, we have to understand what the reality is. When you have corporate executives arguing to raise retirement age to 70 and their average retirement benefit personally is \$14.5 million apiece, they should go to Lake Erie, they should go to Toledo, and they should talk to these people and say, as I say to the audiences, all those who want to live on \$14,500 a year, raise your hand, which is the average Social Security benefit.

I do not get a lot of takers for that. So we need to ground people in what the reality is—not just the math, but the reality. And we have to be aware of averages. I think that is so important. I think you have sort of parsed the numbers correctly, which is the average this and the average that.

Well, Dean made the comment, and Andrew is well-aware of this: there is a very uneven situation going on here, where, if you are white, well-educated, and affluent, you are going to live longer and benefit more, but, if you do not happen to have those tools and those basic situations, you are going to be challenged.

As I said before, younger workers have a 1 in 3 chance of encountering disability or not reaching retirement age because of some problem, and that proportion goes up in communities of color, and that is significant. So let us get the reality and the data out there.

The second thing is, I think we heard suggestions—as part of this conversation we are trying to have about retirement, not about deficit, but retirement—of strengthening the system at the low end. We ought to look at that in terms of the adequacy issue.

The third thing is, there is no doubt we can all do a better job of saving. And one of the challenges is utilizing the mechanisms that people in Mr. Sweeney's business have and some of the suggestions that Andrew made to encourage saving and, at the same time, building on that foundational piece, which is Social Security. It is the foundational piece, and, if we weaken that or limit that, I think we have to face the reality of what is going on: stagnant wages, pensions disappearing, and savings under challenge.

I mean, think about what we just heard with Senator Nelson and Mr. Sweeney. Well, the average income in this country is \$50,000. So, using Mr. Sweeney's 8 times, that means people have to have \$400,000 in order to take care of themselves lifetime.

What is the reality of that? The reality is a vast number of Americans are not even close. Some are, and good luck to them, and congratulations to them.

Senator BROWN. Do others on the panel want to respond to that?

Mr. BAKER. Yes. A couple of points. First off, I think the point you made about the Affordable Care Act is a hugely important one that has not gotten enough attention. There are going to be a lot of people like this woman who are 63, in bad health, who are strug-

gling to go to work every day, who now will be able to get health care insurance, and that is going to make a huge, huge difference in their life, which I think I am happy for. I appreciate that Congress voted the Affordable Care Act in for that reason.

The other point is that there are these huge differences; people are, obviously, in different circumstances. Those of us in our suits with desk jobs, yes, we could work until 70. Many of us will; many of us will want to. It is a very, very different world for most of the workforce.

And one of the things I was struck by, if you read the Bowles-Simpson proposal to raise the retirement age, they actually say we should carve out certain occupations and not raise it for them, which I have to say I got kind of a kick out of, because that was actually the thing that Greece was ridiculed for when they had this huge deficit, because everyone jumped on the bandwagon. Apparently, if you were a hairdresser in Greece, you could retire at age 50, and the rationale was, they work with dangerous chemicals.

I have no idea about the truth of that, but that is the sort of thing that Bowles and Simpson were proposing. That gets you into a nightmare story that I think we do not want to deal with, but it does show at least that they recognized the problem, and I give them credit for it. But it was not a very good way to deal with it.

Senator BROWN. Anyone else?

Mr. BIGGS. Sure, just quickly. I think this goes back to the example that Senator Nelson and Mr. Sweeney had and the comment that you made that, well, somebody making \$50,000, they need 8 times their annual income in savings. How are they going to get that?

The fact is, they do not need 8 times their annual income in savings, because they are getting Social Security. Social Security is a much bigger part of their retirement than it will be for somebody making \$150,000 per year.

Retirement planning is really complicated. It depends on what your income level is, how many kids you have had, are you single, are you married. It is very easy to take these rules of thumb and misapply them. I cannot tell you, off the top of my head, how much savings somebody making \$50,000 a year should have. It is not 8 times their annual income, I will tell you that for certain.

Just a second point which goes back to, I think, the problem you raised of the retirement age. Back in the early 1960s, we lowered the retirement age from age 65 to 62 for precisely the reasons you pointed out. We have laborers, we have people with physically demanding jobs. They cannot make it to 65.

For those folks, I agree with you: 62 is fine. The problem is, it was not just those folks who retired at 62. It was everybody who retired at 62. What do we do then? One idea to encourage people to work longer is, I propose eliminating the Social Security payroll tax for workers aged 62 and over. There are technical reasons why you want to do it, but the point is to give people sort of a carrot, as well as a stick.

Senator BROWN. Excuse me for interrupting, but let me ask you another question about that, Mr. Biggs. That would mean that their monthly check would not grow. I mean, I understand the difference of 63 now and 66, and you get more if you retire at 66, if

you wait. But the reason a 70-year-old gets more is because they have paid in those 4 years.

Mr. BIGGS. That is actually untrue.

Senator BROWN. That is not true? Why do they get more?

Mr. BIGGS. I did a study a few years ago looking at a 62-year-old who chooses to delay retirement for a year and pay an extra year of taxes. For each additional \$1 of taxes a new retiree pays in, they get about 2 cents back in additional benefits.

Senator BROWN. Well, do not do it between 62 and 65 or 63 and 66, because it has gone up. Do it so there is no penalty involved. Is that the case? If you retire at 66 versus retire at 70 and you are paying into Social Security those 4 extra years because you are working, as Mr. Sweeney suggests, does that mean your retirement does not go up because you paid more in?

Mr. BIGGS. Your retirement benefit goes up solely because you delay claiming the benefit. It goes up almost nothing because of the additional taxes you pay. The sort of marginal return is essentially zero, and that is because—two reasons.

One, Social Security is based on your highest 35 years of earnings. So the 36th year is unlikely to raise your benefits by much or anything.

Second, most women continue to get a spousal benefit. So, if they work longer, they are not getting anything in exchange for their own taxes. They are getting something based on their husband. So if they work longer, they essentially get nothing.

I was shocked when we actually ran these numbers, but when you work through the benefit formula, it is clear why it happens.

So the fairest thing for people in that age range actually is to eliminate the payroll tax, but it is also something which the academic research indicates would have a really big response in terms of labor supply, because these are folks who can work a little bit longer if you really make it worth their while, and it might help somebody who had a physically demanding job.

They may say, "Look, I don't really want to be a Wal-Mart greeter," or something like that, but if you eliminate that payroll tax, it becomes a little bit more attractive. They can stay in the workforce a little bit longer.

So it is trying to use the carrot, as well as the stick on this end. I understand that some people need to retire early, but a lot of people can and should retire later, and the question is, how do we encourage that?

Senator BROWN. Thank you.

Mr. Sweeney, do you want to comment or not?

Mr. SWEENEY. Senator Brown, an example. I think about expenses, and that is really the primary basis on which we look at retirement plans.

So I think of an example I saw with a client in California. He had just retired from the University Medical System at age 62, and he came in and talked with a representative about his options, and he still had 15 years left on his mortgage.

And he said, "I'd like to take some of my assets and pay down my living expenses for the next 3 years, until I can take Social Security at 65." The representative said, "Sir, you know, this is going to be really challenging. You are drawing down a significant por-

tion of your assets to live on them for 3 years, and that is going to put the tail end of your retirement plan at risk. When you are in your 80s, you may run out of money."

And it was a challenging conversation to have with him, but he had already decided to retire. If we could have that conversation with people before they actually choose to retire, if he could have worked for another 3 years and been in a very good place, he could have downsized his home, paid off his mortgage, made other choices about spending, which would have made his retirement much more successful.

Senator BROWN. Thank you.

Senator Casey?

Senator CASEY. Thanks very much.

I was looking at, Mr. Baker, your testimony on page 2 and the really startling numbers on a couple of segments of the population. We look at the unemployment rates monthly or look at poverty rates, but the data you have here indicates that, for senior non-married women, the poverty rate is 16.3 percent by the official measure, with another 11 percent near-poor. So, if you add poverty and the near-poor, it is, I guess, 27.3 percent. For the next category, African-American seniors, if you do the same addition, it is 28 percent. Then I think the same calculation, poverty and near-poor, for Hispanic seniors is about the same, 28.2 percent.

They are just startling numbers, and I think another reminder as to why Social Security is so important for folks across the board.

Is there anything you want to say about that? I just was pointing that out.

Mr. BAKER. I appreciate you bringing that up, and this gets to the point I was making earlier about how increasing benefits for those at the bottom can make a very big difference. So I was suggesting if you were to raise benefits for people at the bottom 10 to 15 percent, that makes a huge difference in their standard of living.

These are people just struggling to get by. The cost for raising their benefits is very, very low. So even though, obviously, I know the long-term projections for Social Security, debt is affected very little by raising those benefits for those at the bottom.

Senator CASEY. I know, Mr. Biggs, you indicated on page 2 of your testimony, and I am quoting, "Benefits for low earners probably should be enhanced," unquote. So you are—

Mr. BIGGS. I have argued for a more far-reaching reform, similar to what you have in New Zealand or the U.K., where every retiree receives a flat benefit at the poverty level. So the idea is, you take poverty among seniors, which today is 9 percent, down to 0 percent. On top of that, though, if you want a benefit above poverty, we need to sign people up for employer-sponsored plans or IRAs or something along those lines.

Social Security—I am not going to say it does not cut poverty. Clearly, it does. Is it the most effective, efficient way to reduce poverty? No. We could give every senior in America a poverty-level retirement benefit for half of what we spend on Social Security.

We can do better, but it is not just by saying we need across-the-board increases in benefits. It is saying, who is being poorly served? Why are some people not receiving the benefits they

should? It comes about because of the complexity of the benefit formula.

It bases your benefits on your lifetime earnings, but a lot of things other than your lifetime earnings. Lifetime earnings are not the most important determinant of your benefits. Other factors are actually more important than that.

So it is not a well-targeted benefit. It is a risky benefit for low-income people.

Senator CASEY. Mr. Romasco, I wanted to commend you for doing calculations for our States. On page 8 you say, and I am quoting, "In Pennsylvania, Social Security benefits supported 470,442 jobs, \$70.9 billion in output, and \$4 billion in State and local tax revenues," unquote.

That is very helpful, for us to have that information, and your calculations will be used at another time. We are grateful for that, because sometimes it is difficult for people, and sometimes difficult for elected officials too, to clearly articulate the benefits in a broader-based way. We try to use bang-for-the-buck calculations all the time because it is one way to talk about these issues. So we appreciate that.

I know we are nearing the end, Mr. Sweeney, so I am not going to go through too many questions for you, other than to point out for the record—Senator Brown may not know this, but Mr. Sweeney went to the greatest undergraduate institution in the world, Holy Cross. I wanted to leave him—

Senator BROWN. With a name like Sweeney, that is shocking. [Laughter.]

Senator CASEY. I have four daughters, Mr. Sweeney, and I am just realizing, with your chart, when you indicate Generation Y was born 1978 to 1990, I realize that our oldest daughter is in Generation Y, and the next three, I guess, are millennials.

The chart you have on Gen Y tells a lot about—you have a lot of red there, meaning their potential or their likelihood of saving is not very high up on the scale. So, what would you say to both the Gen Ys and even the younger folks, the millennials; what advice do you have for them—

Mr. SWEENEY. That finding was actually surprising.

Senator CASEY [continuing]. So I can tell my daughters?

Mr. SWEENEY. Please. I will be happy to talk with them as well, if that is helpful.

I would say two things. We were surprised to find that Gen Y was so red because they had so much more time to correct the trajectory that they were on.

Two things. The goal post—

Senator CASEY. Explain red again, just so—

Mr. SWEENEY. It meant that they were not on track to cover their essential expenses in retirement.

There are two big drivers. They are not saving enough, but the second big driver is that their goal post has been moved further down the field than today's generation of boomers. And by that, I mean that they are not going to be covered by defined benefit plans to the degree that today's retirees are covered. So they are going to have to save more on their own. And, as we think about people living longer, your daughters will live longer than your parents,

and so the time frame over which they need to cover their own retirement expenses is going to be longer.

So those are the two biggest predictors and factors that we need to make sure that Gen Y and millennials really understand today so they start saving early with that first paycheck. We want them to be putting 15 percent in, if they can.

Senator CASEY. Great. Thank you very much.

Senator BROWN. Thank you, Senator Casey.

A couple of more questions. If Senator Casey has another round, he can do it. Otherwise, we will wrap up.

A number of you have seen or you know these general statistics that last year, a Pew poll asked respondents, asked young people, if there will be enough money to provide Social Security and Medicare benefits at their current levels. Forty-one percent of those 18 to 29 answered "likely;" 36 percent of 30- to 49-year-olds answered "likely."

You have heard, too, for some years, and I think I have heard this for literally a number of decades, the line that—I do not know if this was actually a survey or somebody just thought it was clever—young people feel more likely that they are going to meet Elvis Presley than that they are going to draw Social Security. Not particularly funny, I do not think.

But reassure us, Mr. Baker, that that is not going to be the case.

Mr. BAKER. Well, I could give you two answers. I could tell you the one I often give to young people. I have spoken at many colleges around the country and ask that question, do you think you will get Social Security, and no one raises their hand. And then I say, "Well, so at some point, we are going to stop paying benefits," and they are all kind of nodding their heads.

So I say, "Okay. So let's pick a year, 2030 or whatever," and I say, "Okay. Will we still have Congress?" "Yes." "Will we still have the military? Will we still have roads?" And then I say, "Okay. And retirees are going to be twice as large as a percent of the population, the voting population, as they are today. Do you think members of Congress are going to vote to cut Social Security, get rid of Social Security?" And most of them are convinced "no."

But in terms of the data, the shortfalls—it is easy to make these sound very large, and it is kind of a game that certainly a lot of people in Washington play, where they talk about tens of trillions, hundreds of trillions. The reality here is that these shortfalls are not very large relative to the size of the economy. So the projected shortfall in Social Security: we are talking about a shortfall of around 1 percentage point of GDP—hardly trivial. But on the other hand, when we fought the wars in Iraq and Afghanistan, we increased military spending by 1.6 percentage points of GDP. I will not say that had no impact, but it did not wreck our economy, and we have a much longer time frame to adjust to this.

With health care, we do face very large costs, but that is basically because our health care system is broken. We spend more than twice as much per person, on average, as people in Germany, France, Canada, whomever you want to throw into that mix.

There, the real key is the question of fixing our health care system, and, if we do not fix that, whether or not we have Medicare

and Medicaid—we could eliminate the government health care programs—we have a nightmare on our hands.

If we do fix our health care system, then the costs are easily manageable, and, again, the very good news there has been that there has been a sharp slowing of costs over the last 5 years. I do not have a crystal ball. I do not know if that will continue. But if that does continue, then health care is going to be very much a manageable problem.

So, again, we can make these sound like scary numbers. If we express these shortfalls as a share of income, again, it does not make them trivial, but these are expenses we have dealt with in many other contexts.

Senator BROWN. Thank you for that.

Let me ask a question of all four of you, and we will wrap up with that.

You have all testified only about the challenges. You have found areas of agreement. You certainly disagreed on some things, but I think you have laid out the challenges of the issues and the options pretty well.

Just give me a couple of minutes each. Senator Casey asked the question, sort of the lightning round he said. This is sort of a lightning round squared maybe, on sort of short-term, what do we do now?

But would you paint for us—take a couple of minutes each or no more than that, if you can, on what a retirement system in this country should look like 5 years from now, what you would like us to work toward, painting that picture of what the retirement system should look like.

Mr. Sweeney, why don't you start, and we will go across that way?

Mr. SWEENEY. Great. Thank you, Senator. I would say two things. This education and guidance issue is of paramount importance. People come to us, and they have one paycheck, and they have multiple needs, and they say, "I need help."

We have proposals in front of us that say we might limit the amount of guidance and advice that we provide based on the type of account that they are working with. We need to make sure that we take a client-oriented view to that and say, "How can I help you, as an individual, as a worker, solve the multiple needs that you have?"

The second thing would be that we think that these default enrollment and auto-enrollment features are incredibly successful, and we want to do more of those. We want to build on the strength of the Pension Protection Act and essentially create another round of that, which will put people in the right products, help them stay invested in equities in the downturn, in the volatility.

We have seen that people who have stayed the course through the downturn in 2008 and 2009 actually are in much better shape than those who panicked and pulled out. So the more we can help people understand that their time frame over which they are investing is fairly long, and the more we can do to get them enrolled, save at a high rate, and be well-invested, the more successful our American workers are going to be.

Senator BROWN. Thank you.

Mr. Baker?

Mr. BAKER. Well, I guess a couple points. First, as I was saying, with Social Security, I think we can take some steps to enhance it, particularly for low- and moderate-income workers. It can make a very, very big difference to a lot of people at relatively low cost.

The other point that I was making is, I think we can set up a system of portable, universal accounts, voluntary, but with a strong, say, default contribution, the key point being here that people can carry these place to place. They would have very limited options, very low cost.

There has been bipartisan support for this, by the way, in a number of States. Washington State, California, came close to passing these on several occasions, but they were stopped by the recession really.

So I think something like that would be very good, basically, as the supplemental retirement vehicle for middle- and upper middle-income people.

One final point. I think it does not get appreciated that, when people talk about future generations, we see huge fluctuations in asset prices that will dwarf the impact of the deficit and debt on future generations. So when housing prices fell by 30 percent, that was really bad news for everyone who owned a house. On the other hand, it is great news for your kids.

It is the same story with the stock market that people should appreciate. So on the one hand, as someone who is invested in 401(k)s, great, I am happy to see the market go up. What that is going to mean is that anyone investing tomorrow could expect lower returns.

And just a very, very simple story. Traditionally, if we had historic price-to-earnings ratios, you can count on roughly a 7-percent real return in the stock market. Given price-to-earnings ratios today, you can count on roughly 5 percent. That is over the long term. That means if I were to put \$1,000 in the market today and keep it there for 40 years, the 7-percent return would get me \$16,000, and the 5-percent return would get me \$8,000.

So people who are worried about generational equity, they should be looking at the stock markets—bad news for that.

Senator BROWN. Mr. Biggs?

Mr. BIGGS. I would agree with Dean and John about really starting with enhancing the savings done by folks through their retirement plans. The auto-enrollment, auto-escalation, life cycle funds, the sorts of things we talked about today, those are the simplest and easiest ways to ensure that people will have adequate retirement savings.

We have done the research. We know a lot more about what goes into retirement saving today than we did 10 or 20 years ago. That would solve, I really think, the vast majority of the problems we face. If people just saved as they should, it is not just better for them, but it makes life easier for Social Security, because Social Security does not then have to worry about paying a big benefit to somebody making \$150,000 per year. So I think that is really the first thing that is actually achievable today, because there really is bipartisan agreement on how to do that.



In terms of Social Security itself, I think we need a more robust safety net on the bottom. Dean and I may differ a little bit about exactly how you do that, but I think we agree that it should be a better safety net, that a country as rich as ours should not be allowing so many folks to retire into poverty.

I think it would be a simpler system, and I think we need to make middle- and high-income folks rely on themselves a little bit more for their retirement savings, because the challenges in Medicare and Medicaid are still out there.

Senator BROWN. Thank you, Mr. Biggs.

Mr. Romasco?

Mr. ROMASCO. Well, I think what we have seen this morning is a broad set of ideas that deal with the retirement issue, and I think it is in that context that we have to change the conversation, as these hearings are designed to do. Let us look at it in that context.

Let us look at Social Security. People need to understand Social Security in all its dimensions—the income-protection piece as well as the retirement piece—and I think that is a first step, because, unless we sort of clarify that, people will still have misconceptions about what it is, what it is not; it is solvent, it is not broke, those kinds of issues. We have to clarify Social Security.

Secondly, we have to ask the right questions. It is not about solvency only. It is about adequacy and solvency.

And third, we have to look at the other two legs of the stool, and I have heard a lot of suggestions this morning that we support in terms of helping people save more and make that personal responsibility piece as robust as possible.

But until we have come to a place where we put the conversation separately—we look at retirement as a whole, we understand the value of Social Security, the low-income piece, the adequacy piece, and the social insurance aspect of, we are all in this together throughout our working lives—I think we are going to be dealing with a lot of, shall I say, unnecessary noise.

So the clarification of that and the support of the other two legs of the stool in terms of the reforms, of some of the suggestions we have heard, in that context, we can have a good conversation, and I have a lot of confidence we will come to a good resolution.

Senator BROWN. Senator Cardin?

Senator CARDIN. First, let me apologize for not being at the hearing. I was chairing the hearing of the Subcommittee on East Asia and the Pacific of the Senate Foreign Relations Committee. One of the challenges of the United States Senate is that they put you on a lot of committees that have a lot of hearings.

So I really regret it, because I think this hearing is very, very important, and I thank Senator Brown for convening this hearing on the importance of not just Social Security, but private savings on retirement, which is critical.

Then-Congressman Portman and I worked on these issues when we were in the House, and it was interesting that, during the most robust time of our economic growth, American savings ratios were incredibly low, in fact negative, for many years when we had a growing economy. And at that time, we were told, do not worry

about it, because people were saving for their retirement through the equities in their homes, and we saw what happened to that.

So I just really wanted to come by to thank the witnesses and to thank the chairman. It is critically important that we not only preserve, but strengthen Social Security. It is the only guaranteed lifetime inflation-proof annuity that people cannot outlive, and they do not have to check to see how the stock market is doing to know what their retirement benefits will be.

It is critically important that we preserve that, but it is also important that we improve incentives for retirement savings. It starts with doing no harm to the tools that are currently available and building on that. The saver's credit has worked. Six million Americans have taken advantage of the saver's credit. We can strengthen that.

And, as has been pointed out by the dialogue that has taken place this morning, there has been discussion about how middle-income and lower-income working families can do better in their retirement. There is no question that we need to do that. We found that the way to do this is to make it easier for people to save for their retirement, that the tax incentives are important, but you need to put something else on the table, and that is why employer-sponsored plans are important.

Where I work, we have that. It is called the Thrift Savings Plan, and Federal employees take advantage of that because they do not want to leave money on the table. And the saver's credit is money on the table, and 6 million Americans have taken advantage of that because they do not want to lose the money that is on the table. That helps them to save.

But I would mention two factors that are important to strengthen these tools, and one is, Americans make a lot of decisions by inaction. We have found that automatic enrollment programs work, and not only do people get involved in the programs, but also the default investment options, which are sensitive usually to their age, provide for the rebalance, which people do not do on their own on their private savings plans.

The second point is, if we were constructing the incentives for private savings and retirement today, I think we would have done a better job putting incentives in for lifetime income options rather than the ease of taking money out of retirement plans today. To me, those are the two areas that we really should be looking at as priorities for improvements to our current incentives.

I have a minute and 21 seconds remaining on my first round, and I still have four more rounds after this. [Laughter.] So, if any of you would like to respond, I would be glad to listen to your response.

Mr. SWEENEY. I would be happy to take that, Senator.

When you talk about income for life—clearly, we talked about longer life expectancies that people need to plan for. Social Security provides a great lifetime income benefit.

We try to use Social Security and model out the cash flows that one might get from that as a core foundation upon which people need to build from their personal and employer-sponsored retirement plans.

With the concept of private annuities or insurance company-sponsored annuities, we find that about 14 percent of Americans have an annuity. The challenge is that people have to write you a fairly large check in exchange for an uncertain stream of cash flows. So, while people who own annuities find great benefit in them—

Senator CARDIN. I would just point out that annuities are one form of lifetime income. There are other ways of doing lifetime income in addition to just private annuities.

But I guess my point is, it is easy to take retirement money and use it for other purposes today without penalty. I am all for having different types of savings incentives for college, for medical emergencies, but retirement is retirement, and I think we should have an easier way to protect retirement income for retirement income flow through a person's life.

And people have outlived their savings so many times today because they say, "Look, I am going to live to be 80," and all of a sudden, at 90, they are still active and they do not have income, and there should have been greater concentration on lifetime income rather than allowing them to take out the money because we had an economic recession or they wanted to buy a home or their grandchild needed money for school. There are other ways to deal with those needs.

Mr. Biggs, you looked like you were agreeing with me. So I will let you get the last word. [Laughter.]

Mr. BIGGS. We have tax incentives in place to encourage retirement saving. I tend to think they are pretty weak, in the sense that you have a tax deferral, not a tax deduction. In theory, you could end up paying more taxes by virtue of saving in an IRA or a 401(k). I think making that more robust might make sense.

I think the saver's credit is a good idea, but I also think having more incentives to encourage annuitization makes sense. I think there is probably never an area where economists are more divided from the public than on annuities. The economic theory says you should essentially annuitize all of your wealth at retirement. That is the most efficient way of allocating your retirement income.

Almost no individual in the general public will willingly annuitize. Very few people want to annuitize their 401(k)s. In defined benefit plans, if you give them the option of a lump sum, they will take it and walk away. It is just a human-nature kind of thing. The joke is, an annuity turns you from a millionaire into somebody getting a \$50,000 income per year, and nobody likes it.

But I think tax incentives or something along those lines, or defaults to encourage annuitization, really could make sense. I think once people have them, they will be happy with them, but the initial decision to do it is such a high hurdle to get over.

Senator CARDIN. Thank you. I really came back to listen to the chairman's closing comments. [Laughter.]

Senator BROWN. Yes, you did. Thank you, Senator Cardin. Few in the Senate know retirement security issues as Ben Cardin does. So I am thrilled that he is here.

Thank you all for testifying. Some members of this subcommittee or the full committee may have written questions for you. If you

would get answers back to us in the next week, I would appreciate it.

I think the hearing was a success in many ways, because the debate should be about the issue of how to achieve retirement security. Mr. Romasco kind of started with that. I think that is particularly important.

These are not budget issues in the same way that they are issues of debate on how we actually do this, especially for low-income workers. And all four of you seem to—when Mr. Baker and Mr. Biggs agree, that is consensus. That means that Senator Toomey and I can agree. So all kinds of things can happen.

But thank you so much. Special thanks to all four of you, to Senator Cardin, and Senators Toomey, Isakson, Casey, Nelson, and Wyden, and to Gideon, Elaina, and Jennifer on my staff. I am really appreciative.

This subcommittee is adjourned.

[Whereupon, at 12 p.m., the hearing was concluded.]

## **A P P E N D I X**

### **ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD**

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#### **“The Importance of Social Security for Sustaining Living Standards in Retirement”**

**Testimony of  
Dean Baker, Co-Director  
Center for Economic and Policy Research**

**At the hearing on  
The Role of Social Security, Defined Benefits, and Private Retirement Accounts in the Face  
of the Retirement Crisis**

**Before the  
Subcommittee on Social Security, Pensions, and Family Policy of the  
U.S. Senate Committee on Finance**

**December 18, 2013**

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I'd like to thank Chairman Brown and Ranking Member Toomey for the opportunity to speak to the subcommittee today about Social Security. I will make three main points in my testimony:

- 1) Social Security is the main source of income for most of the senior population. It keeps most seniors out of poverty and ensures them at least a minimal standard of living in retirement.
- 2) Social Security is likely to be more important to seniors in the decades ahead as a result of the disappearance of the traditional pensions and the inadequacy of 401(k)-type accounts as replacements. Due to the structure of Social Security, most seniors may expect to share in at least some portion of the benefits of economic growth even if the pattern of wage stagnation over the last three decades persists.
- 3) The proposal to change the basis for the indexation of benefits to the CPI-E is consistent with the intent of Congress when it decided to index benefits to inflation in 1975. The goal was presumably to ensure that the purchasing power of benefits kept pace with the inflation rate experienced by seniors. An index that tracks the actual buying patterns of seniors will come closest to meeting this goal.

#### **The Importance of Social Security to Seniors**

Social Security comprises a large and growing share of the income of the senior population. In 1962 Social Security accounted for 30 percent of the income of households including someone over age 65.<sup>1</sup> This share was up to 36 percent in 2011. Since a substantial portion of the over-65

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<sup>1</sup> The numbers in this paragraph are taken from Social Security Administration, 2013. “Fast Facts About Social Security,” [http://www.ssa.gov/policy/docs/chartbooks/fast\\_facts/](http://www.ssa.gov/policy/docs/chartbooks/fast_facts/), accessed 12-16-2013.

population is still working, the share of non-wage income is considerably larger, at 52.2 percent in 2011 compared with 41.7 percent in 1962.

Thirty five percent of senior households rely on Social Security for more than 90 percent of their income, while almost two-thirds of senior households rely on it for more than half of their income. The dependence on Social Security is even greater for unmarried seniors, most of whom are women. It accounts for more than 90 percent of the income for 45 percent of unmarried seniors and more than half of the income of 74 percent of unmarried seniors.

The payback structure is highly progressive, so there is not a large difference between the maximum individual benefit of \$2,530 a month and the average benefit of \$1,300. (This is one reason that means testing would matter little to the finances of the program. The small number of wealthy seniors do not get much more in benefits than a typical beneficiary, so there is little money that can potentially be saved by reducing or eliminating their benefits.) Social Security is the main reason that poverty rates for the elderly are now somewhat below the average for the adult population as a whole, 9.1 percent for seniors compared to 13.7 percent for the population age 18-64.<sup>2</sup> (The gap is smaller when one looks to the Census Bureau's Supplemental Poverty Measure, which is generally viewed as the more accurate measure of poverty. This measure shows a poverty rate of 14.8 percent for seniors compared to 15.5 percent for the aged 18-64 population.<sup>3</sup>) The poverty rate for seniors by either measure would be over 50 percent without income from Social Security.

Poverty rates for senior non-married women and minorities are substantially higher than the overall rate. For senior non-married women the poverty rate is 16.3 percent by the official measure, with another 11.0 percent near poor, for a total of 27.3 percent who are either poor or near poor.<sup>4</sup> In the case of African American seniors, 17.3 fall below the poverty level with another 11.0 percent near poor. For older Hispanics the poverty rate is 18.7 percent, with another 9.5 percent near poor. For the poor and near poor populations, Social Security would provide the overwhelming majority of their income.

Clearly Social Security is a hugely important source of income for seniors. It is most important for moderate and low-income seniors, but the percentage of seniors who could get by without a Social Security check is small. In 2009, 18.5 percent of benefits went to people with non-Social Security income of more than \$30,000 a year (roughly \$32,000 in today's dollars) and less than 10 percent went to people with non-Social Security income of more than \$50,000 a year.<sup>5</sup> In short, the vast majority of Social Security benefits go to people who need it to maintain their standard of living.

<sup>2</sup> Census Bureau, 2013. "Income, Poverty, and Health Insurance Coverage in the United States," [http://www.census.gov/newsroom/releases/archives/income\\_wealth/cb13-165.html](http://www.census.gov/newsroom/releases/archives/income_wealth/cb13-165.html), accessed 12-16-13.

<sup>3</sup> Short, Kathleen, 2013., "The Research Supplemental Poverty Measure: 2012" Census Bureau, [www.census.gov/prod/2013pubs/p60-247.pdf](http://www.census.gov/prod/2013pubs/p60-247.pdf), accessed 12-16-13.

<sup>4</sup> Social Security Administration, 2013. "Fast Facts About Social Security," [http://www.ssa.gov/policy/docs/chartbooks/fast\\_facts/](http://www.ssa.gov/policy/docs/chartbooks/fast_facts/), accessed 12-16-2013.

<sup>5</sup> Baker, Dean and Hye Jin Rho, 2011. "The Potential Savings to Social Security from Means-Testing," Center for Economic and Policy Research, <http://www.cepr.net/index.php/publications/reports/the-potential-savings-to-social-security-from-means-testing>, accessed 12-17-2013.

### The Growing Importance of Social Security through Time

As important as Social Security is for the current population of retirees, it is projected to become even more important in future decades for middle income households, primarily due to the collapse of traditional defined-benefit pensions. While future retirees are projected to receive somewhat more income from defined-contribution retirement accounts than had been the case in prior decades, this will not come close to making up for the loss of traditional pensions.

The Social Security Administration's projections from their MINT model show that for households in the middle quintile at age 67, Social Security benefits will rise from 34.2 percent of income for the cohorts born between 1936-1945 to 37.0 percent of income for the cohorts born between 1966-1975, as shown in Table 1.<sup>6</sup> Since a much larger share of this younger cohort is projected to still be receiving wage income at age 67, the rise in non-wage income is considerably more striking, from 41.9 percent to 48.6 percent. Pulling out imputed rent, Social Security is projected to account for 54.8 percent of non-wage income at age 67 for the middle-income quintile in the cohort born between 1966-1975, up from 46.4 percent for the cohort born between 1936-1945.<sup>7</sup>

**Table 1: Projected Shares of Income at Age 67**

Income quintile	Social Security as a share of	Cohort birth years	
		1936-1945	1966-1975
Bottom	Total income	63.6%	61.5%
	Non-wage income	70.0%	66.7%
	Non-wage and non-rent income	77.8%	72.7%
Middle	Total income	34.2%	37.0%
	Non-wage income	41.9%	48.6%
	Non-wage and non-rent income	46.4%	54.8%
Top	Total income	9.4%	9.1%
	Non-wage income	11.8%	10.4%
	Non-wage and non-rent income	12.4%	11.2%

Source: Butrica et al. Table 5.

The main reason for the growing importance of Social Security for this middle cohort is the virtual collapse in income from traditional pensions. These are projected to fall from 25.0 percent of non-wage, non-rent income to just 3.2 percent of non-wage, non-rent income over this period. Defined-contribution retirement accounts are projected to make up slightly more than half of this shortfall, rising from 10.7 percent of non-wage, non-rent income to 22.6 percent of non-wage, non-rent income.

<sup>6</sup> These numbers are taken from Butrica, Barbara A., Karen E. Smith, and Howard M. Iams, 2012, "This Is Not Your Parents' Retirement: Comparing Retirement Income Across Generations," Social Security Bulletin Vol. 72, #1.

<sup>7</sup> The income figures in the table include a value of imputed rent for owner-occupied housing.

Social Security is projected to continue to account for the bulk of the income for households in the bottom-income quintile. There is a small decline in its projected importance for households in the bottom quintile, primarily due to the growing importance of income from assets, retirement account income and imputed rental income. Social Security is projected to be a declining share of the income for households in the top quintile. This is primarily the result of a sharp projected increase in the income from assets that this group will receive.

The projected rise in the importance of Social Security for the middle-income workers points to both the need to sustain the value of benefits to ensure retirement security for this group and also the need to establish a system of supplemental retirement income to replace defined-benefit pensions. It is worth noting in this respect that the income for this middle quintile at age 67 is projected to rise from \$36,000 per person for 1936-1945 cohorts to \$44,000 for the 1966-1975 cohorts, an increase of 21.1 percent (both figures are in 2011 dollars). As noted earlier, much of this increase is attributable to the fact that people in the younger cohort are more likely to be working at age 67, but after even pulling out earnings there would still be an increase from \$31,000 to \$35,000 per person, a rise of 12.9 percent. This is entirely attributable to a projected rise in Social Security benefits.

This brings up an interesting aspect of the Social Security benefit structure. Even though the Social Security Administration's MINT model projects the wage stagnation of the last three decades to continue, as there is a further upward redistribution of wage income, the benefit structure would still lead to an increase in the size of real benefits. This is the result of the progressive payback structure for benefits and the fact that initial benefits are indexed to *average* real wages.

Table 2 shows benefits, measured in 2013 dollars, for workers with average real earnings of \$10,000 and \$30,000. These figures are not wage indexed, so the assumption is that a worker had the same real wages over his or her lifetime. The columns show the retirement benefits he or she would receive with this earning history in 2002 and in 2032.

**Table 2: Social Security Benefits for Workers Retiring at the Normal Retirement Age**  
(2013 dollars)

Average Lifetime Earnings	Benefits in 2002	Benefits in 2032
\$10,000	\$8,548	\$9,000
\$30,000	\$14,948	\$16,697

Source: Author's calculations

As can be seen, in both cases the benefit is higher in 2032 than 2002. In the case of the worker with average earnings of \$10,000, the increase would be 5.4 percent. In the case of a worker with average earnings of \$30,000, the increase would be 11.7 percent. The reason for the increase is



that the bend points<sup>8</sup> for the payback are indexed to average wages (which rise faster than median wages). If workers do not have increases that rise in step with the average wage, then a larger share of their wage income will fall below the bend points, and therefore be subject to a higher payback rate. The benefits of the hypothetical \$10,000 lifetime average earner are less than that of the \$30,000 lifetime average earner because by 2032 she would already have all her income below the lower bend point. This means that she cannot benefit from further growth in the average wage.

However, for a \$30,000 lifetime earner (which would be close to the actual median), this payback structure helps to ensure that he will get some of the gains from economic growth, even if he has been excluded from these gains during his working years. This is an interesting and arguably desirable feature of the Social Security payback structure. (As a practical matter, it is important to note that the age for receiving full benefits will have risen from 65 to 67 over this period, which is equivalent to a 12 percent cut in benefits.)

There are a couple of points worth noting from the SSA projections and this arithmetic exercise. First, the benefits for low-end earners are not likely to rise in step with economic growth because most of them will have lifetime earnings that already place them below the first bend point. (The projections show an average benefit for the cohort born between 1966 and 1975 of just \$8,000.) If they are to see any gains from economic growth over this period, then it would be necessary to increase the payback rate.

Fortunately it is not expensive to have modest increases in benefits for those in the bottom portion of the income distribution. For example, the Institute for Women's Policy Research and the National Committee to Preserve Social Security and Medicare Foundation have proposed an increase in the basic benefit of 5 percent, or roughly \$55 a month.<sup>9</sup> If this increase was phased out near or somewhat above the average benefit, then it would increase costs by less than 0.3 percent of payroll. Increasing the benefit for surviving spouses to 75 percent of the joint benefit (which also can be capped at the average wage) is another relatively low-cost way to improve retirement security.

The other point is that is clear from these projections is that a new tier to the retirement system is necessary. The ideal would be a voluntary system that would be fully portable between jobs and have low administrative costs. The federal Thrift Savings Plan is an excellent model. It also could be possible to piggyback on state employee retirement systems to allow an experiment on a smaller scale. The idea would be that workers would have the ability to contribute to the system regardless of who their employers are. There would be limited choices of investment options, with a default of a diversified fund, in order to keep the plan simple and to minimize costs. Annuitization would be the default option at retirement. Such proposals have received bipartisan support at both the federal and state levels. Unfortunately, the crisis created by the collapse of the housing bubble has obstructed progress on this front.

<sup>8</sup> Social Security benefits are calculated by applying lower percentages to higher levels of earnings. The "bend points" are the levels at which the percentages drop. See <http://www.ssa.gov/oact/cola/Benefits.html>.

<sup>9</sup> Institute for Women's Policy Research and National Committee to Preserve Social Security and Medicare Foundation, 2013. "Breaking the Social Security Glass Ceiling: A Proposal to Modernize Women's Benefits," [www.ncpssmfoundation.org/Portals/0/breaking\\_ss\\_glass\\_ceiling.pdf](http://www.ncpssmfoundation.org/Portals/0/breaking_ss_glass_ceiling.pdf), accessed 12-17-2013.

### **The Indexation of Benefits Post-Retirement**

The last point that I wanted to briefly address was the indexation formula used to adjust benefits after workers retire. Currently benefits are tied to the rate of inflation as shown by the consumer price index for wage and clerical workers (CPI-W), which was the only CPI in existence at the time that Congress first voted to index benefits in 1975. Since then the Bureau of Labor Statistics (BLS) began fielding the CPI-U, which tracks the rate of price increase for the consumption basket of a typical urban household. More recently, BLS has constructed a research index, the chained CPI (C-CPI-U), which incorporates substitutions in purchases of goods and services in its measure of inflation.

Since people typically substitute from items whose prices are rising rapidly to items whose prices are rising less rapidly, the C-CPI-U has shown a rate of inflation that averages 0.2-0.3 percentage points less than the rate of inflation shown by the CPI-U or the CPI-W. Based on this difference, many political figures have advocated switching the indexation of Social Security benefits from the CPI-W to the C-CPI-U. The Congressional Budget Office has projected that this switch would save more than \$120 billion over a decade as a result of lower benefit payments.

While there is little doubt that a switch to the chained CPI would reduce benefits and save money, there are two important points that Congress must recognize. First, these cuts are substantial. A cut in benefits of 0.2-0.3 percent in a single year may not be of much consequence, but the size of the cut accumulates over time. After ten years, an annual reduction in benefits of 0.3 percentage points implies a 3 percent cut in benefits. After twenty years the cut would be 6 percent and after 30 years it would be 9 percent. (These calculations ignore the impact of compounding.)

Such a pattern would imply sizable cuts in benefits to many people whose sole income is Social Security. In fact, the implied cuts would be considerably larger, measured as a share of income, than the tax increases on the wealthy that were put in place at the end of 2012. While the Obama administration has proposed ways in which the impact of these cuts could be ameliorated, there can be no doubt that they would be felt by a population that for the most part does not fit anyone's definition of wealthy.

The other point is that there is no basis whatsoever for claiming that the C-CPI-U provides a more accurate measure of the rate of inflation experienced by the elderly. The BLS has an experimental index that tracks the specific consumption patterns of seniors, the CPI-E. This index has typically shown a rate of inflation that is 0.2-0.3 percentage points higher than the overall CPI. The reason for the difference is that medical care comprises a much larger share of the expenses of the elderly, and health care costs have typically risen more rapidly than the general rate of inflation.

If the goal is to have a more accurate measure of the rate of inflation experienced by the elderly, then we should want to see Social Security adopt the CPI-E as the basis for indexation. Many have objected to going this route based on the fact that the CPI-E is an experimental index that simply re-weights components of the CPI-U, rather than directly collecting data on prices for the specific items purchased by seniors at the outlets used by seniors. (In fact, the CPIs constructed

by BLS already allow for substitutions between narrow categories of products, such as types of apples. It is possible that this overstates the extent of substitution done by seniors and for this reason understates the rate of inflation they experience.)

While this complaint against the CPI-E is true, the fact that the CPI-E is not a full CPI is a policy choice. If the goal is to have an index that accurately measures the rate of inflation seen by the elderly, then BLS has the expertise to accomplish this task, if Congress were to instruct it to do so. A full elderly index would also allow researchers to determine if seniors substitute purchases to the same extent as the population as a whole. There are many instances where seniors find it less practical to change their consumption patterns than the population as a whole. For example, someone with a heart condition is unlikely to substitute from margarine to butter in response to a price increase in margarine. Also many of the items consumed by seniors may not lend themselves to easy substitution. It is difficult to substitute away from hip surgery or other medical procedures.

If the goal is to have an accurate measure of the rate of inflation experienced by seniors then there is little excuse not to go the route of constructing a full elderly CPI. The notion of tying post-retirement benefits to the rate of inflation certainly seemed to be the intent of Congress back in 1975 when it indexed benefits to the best measure of inflation available at the time.

Congress is free to change its approach to Social Security, but it is simply dishonest to claim that indexing benefits to the chained CPI is an effort to provide a more accurate measure of the rate of inflation. It is intended as a way to reduce benefits and should be evaluated as such.

## **Conclusion**

Social Security is the main source of retirement income for the overwhelming majority of workers. Its importance is projected to grow in the years ahead largely as a result of the collapse of the traditional defined-benefit pension system. There are good arguments that Congress should be looking to expand, rather than cut, Social Security, especially for low-and moderate-income workers. It is also important that Congress understands that proposals to switch the basis for indexing post-retirement benefits to the C-CPI-U involve cuts to Social Security, not making the indexation formula more accurate. If the goal is to have an indexation formula that more closely tracks the rate of inflation experienced by seniors, then Congress should use either the experimental CPI-E already produced by BLS or instruct the agency to construct a full CPI-E.

**Sen. Ron Wyden**  
**Senate Finance Subcommittee on Social Security, Pensions, and Family Policy**  
**Questions for the Record for Dean Baker**  
**12.18.13 Hearing: The Role of Social Security, Defined Benefits, and Private Retirement**  
**Accounts in the Face of the Retirement Crisis**

1. Pension law requires that pension plans and retirement plans be managed solely for the benefit of plan participants. The contributions American workers make into these plans are not supposed to be used by employers or Wall Street to improve a company's bottom line. Yet I'm reading reports of some of America's biggest companies essentially looting their pension plans to finance executive parachutes and downsizing, and to increase their profits. This type of behavior is unacceptable at a time when workers in Oregon and across the country are facing the threat of pension cuts.
  - Which regulations are being exploited by these companies in carrying out these sorts of actions?
  - Do changes need to be made to pension law to better protect American workers from companies using their pension funds for their benefit instead of the benefit of their employees?

I certainly am not an expert on the set of issues involved in regulating these pensions. Most of what I have learned comes from the business press and reading Ellen Schultz's excellent book, *Retirement Heist*. It seems the main issue here is that companies can find ways to pull funds out of their pensions under the guise of "enhancing benefits" even if the measures are actually serving another purpose, such as paying for buyouts.

I don't know if there is any simple remedy that will prevent such gaming. Perhaps if companies were required to get pre-approval from the PBGC of any material change in the structure of its pensions it would remedy this problem. That would still require that the PBGC be prepared to carefully scrutinize any change, but ideally a requirement for pre-approval would discourage companies from trying the more dubious schemes even if some still questionable ones may slip through.

2. A lot of what we've done over the last decade or so is to encourage folks who can already afford to invest more, to invest more. For example, we have increased the limits on annual contributions and created and permanently extended the "catch-up" provision." These measures seem more likely to benefit higher income individuals who have a much easier time saving for retirement.
  - What can be done to better encourage those who most need to save to do so? As you know, middle class workers receive a significantly smaller incentive – a smaller tax benefit – to save since their marginal tax rates are lower than upper income workers.
  - Under current tax law, if a high income earner like me deposits \$100 into a 401(k), I would receive a tax benefit of at least \$30, holding all else equal. If the same \$100

deposit is made by a low-income worker, her tax benefit is likely to be less than \$10.  
Is this incentive to save equitable, and is the tax expenditure appropriately targeted?

**It is hard to avoid seeing the incentive structure as completely backward. We are effectively paying lots of money to relatively high income people to encourage them to save, when most of them would save anyhow. We are giving very little incentive to more moderate income people to save, especially those whose incomes are too low to have any income tax liability.**

**The logic for a fix seems straightforward, even if the politics may not be. If the caps on deductible IRA/401(k) contributions were lowered (e.g. to \$10,000), it would affect a small number of people, most of whom would be saving large amounts anyhow. Furthermore, the deduction could be turned into a credit (e.g. 20-25 percent) so that low income and high income people would get the same incentive per dollar. Ideally, this credit would also be refundable for moderate income households without income tax liability.**

**It would not be hard to structure this so that it is deficit neutral, or nearly so. The reality is that even with better incentives we will not see a huge increase in savings from low and moderate income families, or at least not until we see better wage growth. This means that the cost of incentives for this group will be relatively low. If we had 20 million households increase their savings by an average of \$1,000 a year, and gave them a 25 percent refundable credit, this would only come to \$5 billion a year. That is an amount that could easily be recovered by making the tax benefits for saving to high end earners less generous.**

**I would hope Congress would look in this direction to reform the system. My guess is that such a switch would enjoy a substantial amount of bipartisan support.**

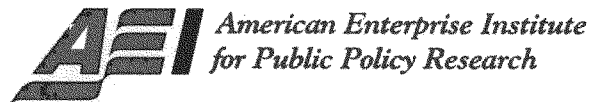
3. Each year, American workers deposit \$175 billion into defined contribution plans, and their employers add almost another \$120 billion in matching contributions for a total of \$295 billion in annual savings for retirement. Yet, over 25 percent of households with a DC plan for retirement have used all or some of their savings from those accounts for non-retirement needs, amounting to over \$70 billion in annual withdrawals. Despite the current unemployment situation, a recent study suggests that only 8 percent of those who have breached their retirement accounts have taken early distributions because they lost their jobs. The vast majority of those making hardship withdrawals are doing so to avoid eviction, pay medical bills or educational expenses, or meet other obligations. With the decline of the more stable and certain benefits of traditional pensions, I am concerned about the effect that early distributions have on the resources available to American workers once they retire. While I understand and appreciate that workers need to know that they can access their savings in an emergency in order to encourage their participation in retirement plans, I am also concerned that the relative ease with which they can draw down those savings may create a retirement crisis in the longer term.

- With that in mind, I would ask the panel, if they were in my shoes on the Finance Committee, whether there is more we can do to reduce leakage from retirement savings accounts without inadvertently discouraging worker participation.

My view is that it would be best to have the possibilities for penalty-free withdrawals be as limited as possible. These are retirement accounts. They are not education accounts, home-buying accounts, or business start-up accounts. People cannot typically borrow against a defined benefit pension and certainly can't borrow against their Social Security. Since very few people know the rules on withdrawals in any case, it is difficult to see how tightening restrictions can have much impact on savings. (Any tightening can be phased in, for example applying to accounts opened after some future date.)

It is possible to show some flexibility on the fines for early withdrawals. For example, it might be desirable to have a somewhat lower penalty if people make withdrawals after age 55 in order to make it easier for people to deal with spells of unemployment or underemployment late in their careers. This also would be easy to enforce, since people cannot easily make false claims about their ages.

Anyhow, we do see a great deal of leakage due to withdrawals for a wide variety of purposes. All of these may have merit, but they come into direct conflict with the goal of having accounts available to support workers in retirement.



Statement before the United States Senate  
Committee on Finance  
Subcommittee on Social Security

## Social Security, Pensions and Retirement Security

Andrew G. Biggs, Ph.D.  
Resident Scholar  
American Enterprise Institute

December 18, 2013

*The views expressed in this testimony are those of the author alone and do not necessarily represent those of the American Enterprise Institute.*

Chairman Brown, Ranking Member Toomey and Members of the Committee:

Thank you for the opportunity to testify with regard to Social Security, pensions and the retirement security of the American people.

I wish to make three main points in my testimony:

- First, Social Security's benefits are more adequate, but its financing less healthy, than many suspect. The principal risk to retirement security today is Social Security's insolvency. Talk of raising Social Security benefits before solvency is restored is irresponsible.
- Second, while some look back on a Golden Age in which most workers received benefits from DB pensions, they overlook the significant downsides to DB plans. I would go so far as to say that, were DB pensions the only plans available today, retirement security would be significantly reduced.
- Third, many of the positive attributes of DB plans can and are being incorporated into DC pensions. While DC plans have shortcomings, these are fixable. Problems with DB plans, by contrast, are more difficult to fix.

#### **Social Security: How Generous?**

With regard to benefit adequacy, the Social Security Administration states that:

Most financial advisors say you'll need about 70 percent of your pre-retirement earnings to comfortably maintain your pre-retirement standard of living. Under current law, if you have average earnings, your Social Security retirement benefits will replace only about 40 percent.<sup>1</sup>

But there is a very basic problem with this statement: financial advisors measure "replacement rates" relative to earnings immediately preceding retirement, while the SSA measures replacement rates relative to the wage-indexed average of the individual's highest 35 years of earnings. The technicalities of this latter measure don't matter; what matters is that financial advisors' 70 percent recommended rate and Social Security's delivered 40 percent replacement rate simply aren't comparable. They are apples and oranges.

**Table 1. Social Security "Final Earnings" Replacement Rates**

Lifetime Earnings Quintile				
Lowest	2 <sup>nd</sup>	3 <sup>rd</sup>	4 <sup>th</sup>	Highest
137%	77%	69%	53%	42%

Source: Springstead and Biggs (2008).  
Applies to retired beneficiaries age 64-66 in 2005.

In a 2008 research paper with Glenn Springstead of the Social Security Administration<sup>2</sup>, I compared households' initial Social Security benefits to their earnings immediately preceding retirement.<sup>3</sup> As shown in Table 1, for a household in the middle of the earnings distribution Social Security pays a replacement rate of around 69 percent of final

<sup>1</sup> Social Security Administration website; "Social Security Retirement Planner: Decide When to Retire," <http://www.ssa.gov/retire2/>; see also Social Security Administration (2005).

<sup>2</sup> Springstead, Glenn, and Andrew Biggs. "Alternate measures of replacement rates for Social Security benefits and retirement income." Social Security Bulletin 68, no. 2 (2008).

<sup>3</sup> The average of earnings in the five years prior to retirement; years of zero earnings were not included in the average.



earnings, close to financial advisors' recommendations. For lower-income households, replacement rates were higher.

Does this mean that Social Security benefits are overly generous? No. But the case for a broad-based increase in Social Security benefits, as some have proposed, is weak. Benefits for low-earners probably should be enhanced, but there is little reason that households in the top fifth of the earnings distribution should be receiving half their retirement income from the government. These Americans need to save more on their own.<sup>4</sup>

### **Social Security Financing**

Social Security is significantly underfunded. While not a threat for current retirees, insolvency is a major risk for people who are middle aged or younger. These are the very same people for whom we are trying to design better pensions, so it is misguided to ignore Social Security's solvency when thinking about broader retirement security. Speaking personally, nothing poses a greater threat to my own retirement security than the chance of a 25 percent legally-imposed benefit cut at the very time I plan on retiring.

To keep Social Security solvent over 75-years without reducing scheduled benefits would demand an immediate and permanent 20 percent increase in the plan's revenues.<sup>5</sup> But even this is too little, since it assumes that we would collect higher taxes from individuals over that 75-year period and then impose massive benefit cuts in the 76<sup>th</sup> year. This is a misleading measure of Social Security's fiscal demands and, obviously, an unfair policy to follow.

A better measure would be the revenue increases required to keep Social Security solvent over 75 years and financially healthy as of the end of that period (so-called "sustainable solvency"). This would require an even larger immediate and permanent revenue increase of around 29 percent.

The most prominent progressive Social Security reform plan, the "Strengthening Social Security Act of 2013" introduced by Sen. Harkin in March 2013, would raise taxes by nearly this amount (around 27 percent) by repealing the ceiling on taxable earnings, which will be \$117,000 in 2014. However, the proposal would devote around one-third of the additional revenues to raising benefits. As a result, the Harkin proposal would address only one-half of Social Security's 75-year shortfall and extend the trust funds' solvency by only around 16 years.

In the process, this proposal would increase the top tax rate on earned income from the current rate of around 43 percent to about 55 percent.<sup>6</sup> Adding state income taxes, some individuals could pay two-thirds of every additional dollar earned to the government, providing significant incentives to reduce work or

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<sup>4</sup> For a broader outline of Social Security reforms, see Biggs, Andrew G. "A New Vision for Social Security." National Affairs. June 2013., <http://www.nationalaffairs.com/publications/detail/a-new-vision-for-social-security>

<sup>5</sup> The 2013 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds. May 2013. <http://www.ssa.gov/OACT/TR/2013/index.html>.

<sup>6</sup> This includes the increase in income tax rates to 39 percent, the phasing out of the Pease provision, and the 3.9 percent Medicare tax on high earners included in the Affordable Care Act. The average state income tax rate is around 6 percent, with top state tax rates exceeding 13 percent.

exploit tax shelters.<sup>7</sup> And these tax increases would effectively “tap out” high earners before we have addressed the larger problems of Medicare and Medicaid.

#### **Defined benefit pensions**

A defined benefit (DB) pension pays a specified benefit based upon a formula. For instance, the Federal Employees Retirement System is a DB plan and it pays a benefit equal to 1 percent of the worker’s final earnings, multiplied by the number of years of job tenure. A defined contribution (DC) plan, by contrast, is like a 401(k): the employer makes a contribution to the worker’s account – usually around 3 percent of the worker’s wages – but the employee chooses how to allocate the contributions and is subject to the risk of those investments.

While some point to a supposed “Golden Age” of retirement security in which most Americans had traditional defined benefit pensions, the reality is that this Golden Age never existed.

*Coverage under DB plans was never universal.* Employees in large companies generally had DB plans, but smaller firms often did not offer DB plans -- or other kind of pension. Moreover, coverage under DC plans today is higher than believed. For instance, you may here that “only half of private sector employees have access to workplace retirement savings.”<sup>8</sup> But these figures are based on surveys of individuals, who sometimes fail to report pension coverage even if they are offered and participate in one. By contrast, a 2011 study of tax records by the Social Security Administration shows that 72 percent of all private sector workers are offered a retirement plan and 58 percent of them choose to participate. Among larger firms (100 or more employees), 84 percent of workers are offered a pension plan.<sup>9</sup>

*Participating in a DB plan does not mean getting retirement benefits from a DB plan.* For an employee who remains with the same employer throughout his career, DB pensions can provide a generous, stable retirement income. But DB plans short-change individuals who shift jobs mid-career, in two ways. First, employees who change employers after less than five years on the job may fail to vest in their DB pension, meaning that they are ineligible for any benefits in retirement. Since private-sector workers change jobs about every 4.6 years,<sup>10</sup> this is a serious shortcoming.

Second, even employees who vest in a DB plan may fail to receive meaningful benefits. DB plans are “backloaded,” meaning that benefits accrue very slowly through mid-career but then shoot up toward retirement. For instance, consider two employees: one works at the same employer for 40 years, while the second works at four employers for 10 years each. If these individuals have DC plans, they would receive approximately the same benefits at retirement. If they were offered DB plans, by contrast, the short-tenure worker would receive a benefit only around 40 percent as high as the long-tenure worker.

<sup>7</sup> See Biggs, Andrew G. “The Case against Raising the Social Security Tax Max.” American Enterprise Institute Retirement Policy Outlook No. 1. March, 2011.

<sup>8</sup> Rhee, Nari. “The Retirement Savings Crisis: Is It Worse Than We Think?” National Institute for Retirement Security. June 2013.

<sup>9</sup> Dushi, Irena, Howard M. Iams, and Jules Lichtenstein. “Assessment of Retirement Plan Coverage by Firm Size, Using W-2 Tax Records.” Soc. Sec. Bull. 71 (2011): 53.

<sup>10</sup> Bureau of Labor Statistics. “Employee Tenure in 2012.” <http://www.bls.gov/news.release/pdf/tenure.pdf>

This is not merely a theoretical problem. According to Olivia Mitchell, professor at the Wharton School and head of the Pension Research Council, only 1-in-10 employees who participate in a DB plan will collect benefits from it.<sup>11</sup> Simply put, a world in which workers only had DB pensions would be one with significantly reduced retirement security.

**DB plans' advantages: Can they be transferred to DC pensions?**

DB pensions do have several important advantages over DC plans. However, these advantages can be incorporated into DC structures to get, if not the best of both worlds, at least some of the advantages of both.

- *Participation:* Enrollment in DB plans is generally mandatory, while DC plans are optional. As a result, many employees simply fail to sign up for DC pensions. However, so-called "auto-enrollment" can significantly increase employee participation. This approach, which was authorized in the Pension Protection Act of 2006, has spread among plan sponsors. For instance, a survey conducted by the Plan Sponsor Council of America found that in 2006 only 10 percent of plan sponsors used auto-enrollment; by 2010, 24 percent of sponsors used it.<sup>12</sup> However, some are concerned that use of auto-enrollment has not continued to rise since then. Some analysts have suggested making auto-enrollment mandatory among employers who offer plans.<sup>13</sup>
- *Contribution rates:* DB plans also offer a standardized benefit level, whereas some employees contribute too little to DC plans. Even when employers offer auto-enrollment, some do so at low employee contribution levels. This could potentially *reduce* retirement saving for at least some employees, who may not bother to raise contributions above the default level. Increasing the deferral rate under auto-enrollment is a step that could relatively easily raise employee saving and increase retirement security.
- *Administrative costs:* Some argue that management costs for 401(k) plans are too high. In many cases, I agree. Some administrative costs are inevitable, and because these costs are fixed small-employer 401(k) plans have higher fees than large plans. But there is little reason why plans should offer dozens of investment options, often with high fees attached. A limited number of low-cost index funds, such as offered through the federal government's Thrift Savings Plans, would be both more understandable to participants choosing how to invest and provide higher net returns and benefits at retirement.
- *Asset allocation:* It is argued that individuals are unable to effectively manage their investments. These claims are a mix of truth and overstatement. Many individuals fail to monitor their investments and do not alter asset allocations over time. But there does not appear to be excessive "day trading" by DC pension participants. For instance, only around 3,000 of the Thrift Savings Plan's roughly 4.5 million participants took part in active trading, meaning rapidly shifting

<sup>11</sup> "What America's Private Retirement System Gets Right." ThinkAdvisor.com. December 6, 2013

<sup>12</sup> David L. Wray. "The Private Employer System Passes Its Stress Test." Spring 2011 Pension Research Council Conference at the Wharton School. May 5-6, 2011.

<sup>13</sup> See "Alicia Munnell: Make 401(k) Auto-Enrollment Mandatory." ThinkAdvisor.com. July 4, 2013

portfolios in attempts to time the market.<sup>14</sup> The introduction of “life cycle” funds, which automatically shift from stocks to bonds as an employee approaches retirement, can make asset allocation easier.

- *Annuitization*: DB plans generally pay benefits as an annuity (a monthly income for life) while DC plans usually pay out lump sums. Annuities are valuable in helping retirees avoid outliving their assets. However, most retirees already receive a substantial portion of their retirement income as an annuity through Social Security. Moreover, there is no reason DC plans cannot offer annuities as a payout option. The real problem is that, for whatever reason, individuals don’t like annuities. Very few purchase annuities, and when DB plans offer lump-sum payouts many participants choose them. This may appear irrational to economists, but it is very clearly what people prefer. If policymakers wish to increase annuitization of pension balances, they must either consider incentives (say, making 401(k) balances converted to annuities permanently tax-free) or mandate annuitization.

#### **Problem (Almost) Solved**

It is tempting to conclude that the systems we have don’t work and cannot work. In reality, though, simple steps could go most of the way toward fixing the shortcomings of the U.S. retirement saving system.

Consider a defined contribution pension which had

- automatic enrollment...
- at a healthy saving rate...
- invested in a life-cycle portfolio...
- composed of low-cost index funds and...
- at least partially converted to an annuity at retirement.

Such a plan would address most of the concerns raised over retirement security today, with very limited downsides for individuals and no risk to the taxpayer. Moreover, nearly all of this would be allowable under current law.

What can Congress do? First, inform yourselves of the best research available. Retirement security is burgeoning field and today we know much more about how to promote saving than we did a decade or more ago. Second, support this research where you can. The Social Security Administration’s Retirement Research Consortium has done excellent work in this field. But the SSA’s efforts to promote similar work on financial literacy and planning were canceled due to lost funding. Third, raise awareness of these issues among your constituents, including employers. Retirement plans are improving today largely because employers are learning what works. And fourth, fix the programs you have before thinking about enhancing them or starting new programs.

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<sup>14</sup> See “Final Ruling: No More TSP Frequent Trading,” [www.myfederalretirement.com](http://www.myfederalretirement.com). April 24, 2008. To prevent this small cohort of active traders from increasing fund management fees for others, the TSP restricted interfund transfers to two per month.

Answers to Questions for the Record Submitted by Sen. Ron Wyden following Hearing on “The Role of Social Security, Defined Benefits, and Private Retirement Accounts in the Face of the Retirement Crisis.” Senate Finance Subcommittee on Social Security, Pensions, and Family Policy, December 18, 2013.

Andrew G. Biggs  
Resident Scholar  
The American Enterprise Institute  
January 24, 2014

I would like to note at the outset that, while I work for the American Enterprise Institute in Washington, D.C., I am a resident of Klamath Falls, Oregon and appreciate the service that Sen. Wyden renders to region and to the state. Sen. Wyden’s questions and my responses follow below.

1. *Pension law requires that pension plans and retirement plans be managed solely for the benefit of plan participants. The contributions American workers make into these plans are not supposed to be used by employers or Wall Street to improve a company’s bottom line. Yet I’m reading reports of some of America’s biggest companies essentially looting their pension plans to finance executive parachutes and downsizing, and to increase their profits. This type of behavior is unacceptable at a time when workers in Oregon and across the country are facing the threat of pension cuts.*
  - *Which regulations are being exploited by these companies in carrying out these sorts of actions?*
  - *Do changes need to be made to pension law to better protect American workers from companies using their pension funds for their benefit instead of the benefit of their employees?*

It is important to distinguish between legitimate and illegitimate changes to pension plans. For instance, some have cited General Electric’s closing of its defined benefit plan to new entrants in 2010. But such a change would not affect either the accrued or future benefits of current employees. There has been no “heist” of benefits, as author Ellen Schutlze has contended, because all benefits owed have continued to be paid. If GE is underpaying its newly-hired employees who are offered 401(k) plans, it will be unable to attract and retain employees.<sup>1</sup>

Moreover, the federal government shut its own DB plan to new entrants in the 1980s and placed newly-hired workers into a smaller DB and a DC pension plan. In addition, the federal government has raised pension contributions for employees. In both the corporate sector and the federal government, these changes will be judged in the labor market: that is, can these entities continue to attract the employees they need. (I suspect they will be able to, but time will tell.)

However, there have also been funding practices that – while not illegal – may not be advisable from a broader perspective of fully funding plans and protecting participants and the taxpayer. In the distant past, corporate pensions were lightly regulated. However, since the passage of ERISA in 1974 defined benefit pensions in the corporate sector are far more heavily regulated, and benefits are eligible for protection from the Pension Benefit Guaranty Corporation. ERISA and subsequent reforms, including the Pension Protection Act of 2006, have tightened funding requirements and eliminated certain avenues for abuse.<sup>2</sup>

<sup>1</sup> Likewise, if GE is overcompensating its executives through generous pensions or other forms of pay, then its management is shortchanging GE’s shareholders (a so-called “principal-agent problem”). But activist shareholders have the opportunity to address these issues.

<sup>2</sup> For additional details on pension regulation and funding see Brown, Jeffrey R. and Andrew G. Biggs. “Reforming the Pension Benefit Guaranty Corporation.” In *Private Markets and Public Insurance Programs*, (Eds: Jeffrey R. Brown), American Enterprise Institute Press: Washington, DC, 2010

That said, my basic concern with DB pension plans is that they provide too many opportunities for plan sponsors, in the private sector and all levels of government, to promise benefits without fully paying for them. If the sponsor of a DC pension promises a given employer match each year, it is very clear to participants whether that match has been paid. But the sponsor of a DB plan who wishes to reduce its contributions has multiple avenues for doing so: increase its discount rate, or alter assumptions regarding longevity, or wage growth, or quit rates, and so on.

Every assumption change might be just slightly optimistic and individually defensible, but cumulatively they can result in pension benefits being significantly underfunded over the long term. Yet, given the complexity of DB pension plans and the inevitable ability of plan sponsors to influence legislation and regulation, it is very difficult to imagine policy steps that can be taken to ensure that DB pensions are fully funded. Responsible employers – and there are many – will fund responsibly, while less responsible plan sponsors will not fund responsibly.

For instance, in 2012 pension plans lobbied for and, through the passage of the Highway Bill, received permission to use a higher “discount rate” in calculating the value of their liabilities and the contributions needed to fund them. Interest rates are currently low, so the plans received permission to value their liabilities using a higher discount rate based on average bond yields over the prior 25 years. This higher rate lowered the present value of their liabilities and reduced the contributions the plans needed to make, which was precisely the point of their lobbying. What matters for funding pensions is the interest rate *today*, since that reflects the cost today of funding a given payment in the future. The interest rate 25 years ago does not affect the true economic costs to a pension today.

In other words, these aren’t problems with current federal regulations so much as problems with DB plans in general. So long as there are plan sponsors who do not wish to fully fund their pensions, at least some will be able to do so because it is impossible for the federal government to monitor and dictate every variable by which funding decisions are made.

Thus, I tend to think that a reformed and improved DC system is the road to retirement security in the future. As I noted in my prepared testimony, a DC plan that include automatic enrollment; high default contribution levels; default investment in a life cycle fund composed of low-cost index funds; and incentives to annuitize account balances at retirement, would solve most of the problems that cause some to believe we have a crisis in retirement preparedness.

2. *A lot of what we’ve done over the last decade or so is to encourage folks who can already afford to invest more, to invest more. For example, we have increased the limits on annual contributions and created and permanently extended the “catch-up” provision.” These measures seem more likely to benefit higher income individuals who have a much easier time saving for retirement.*
  - *What can be done to better encourage those who most need to save to do so? As you know, middle class workers receive a significantly smaller incentive – a smaller tax benefit – to save since their marginal tax rates are lower than upper income workers.*
  - *Under current tax law, if a high income earner like me deposits \$100 into a 401(k), I would receive a tax benefit of at least \$30, holding all else equal. If the same \$100 deposit is made by a low-income worker, her tax benefit is likely to be less than \$10. Is this incentive to save is equitable, and is the tax expenditure appropriately targeted?*

This example illustrates how tax incentives for retirement saving may easily be misunderstood. The tax *deferral* granted to 401(k) contributions differs greatly from the tax *exemption* granted to, say, employer-provided health coverage. A tax exemption is a pure gain to the taxpayer and a loss to the federal budget. Moreover, the value of the exemption is easily calculated by examining the marginal tax rate of the

taxpayer involved, as illustrated in the example above. A tax deferral, by contrast, does not eliminate taxes so much as delay them. The tax deferral for retirement saving reduces taxes today but imposes taxes in the future. While there is still a net benefit involved, the tax incentives to save for retirement are far weaker than, say, for employers to provide health coverage to their employees. The revenue losses to the federal government also are smaller.

Moreover, because only a tax deferral is granted, the benefits do not vary as much along income lines as would a tax exemption. Individuals with high marginal tax rates do receive a greater benefit from retirement tax deferrals than do individuals paying lower rates, but the differences are smaller than they appear. In the example above, Sen. Wyden receives three times the tax benefit of the individual paying a 10 percent tax rate; once we account for different tax rates in retirement, however, the net tax benefit to Sen. Wyden is probably around 50 percent greater than for the low-income worker.

Equitability is more difficult to judge. Sen. Wyden does receive a larger tax benefit, but it is likely to be a smaller benefit relative to his income. Similarly, Sen. Wyden likely has a greater need to save for retirement, as he will receive a lower replacement rate from Social Security than a lower-income individual.

I do believe that such incentives could be better-targeted and more effective. First, I would shift the current tax deferral into a true tax exemption. Money that individuals save for retirement would not be subject to taxes upon withdrawal. Second, the tax exemption might be more limited in scope and the exemption might be applied to payroll as well as income taxes. This should target the tax preference more toward lower and middle-income households.

3. *Each year, American workers deposit \$175 billion into defined contribution plans, and their employers add almost another \$120 billion in matching contributions for a total of \$295 billion in annual savings for retirement. Yet, over 25 percent of households with a DC plan for retirement have used all or some of their savings from those accounts for non-retirement needs, amounting to over \$70 billion in annual withdrawals. Despite the current unemployment situation, a recent study suggests that only 8 percent of those who have breached their retirement accounts have taken early distributions because they lost their jobs. The vast majority of those making hardship withdrawals are doing so to avoid eviction, pay medical bills or educational expenses, or meet other obligations. With the decline of the more stable and certain benefits of traditional pensions, I am concerned about the effect that early distributions have on the resources available to American workers once they retire. While I understand and appreciate that workers need to know that they can access their savings in an emergency in order to encourage their participation in retirement plans, I am also concerned that the relative ease with which they can draw down those savings may create a retirement crisis in the longer term.*

- *With that in mind, I would ask the panel, if they were in my shoes on the Finance Committee, whether there is more we can do to reduce leakage from retirement savings accounts without inadvertently discouraging worker participation.*

First, it is important to gauge the scale of leakage from retirement accounts. Using data from the Health and Retirement Study (HRS), Poterba, Venti and Wise (1999) find that

pre-retirement withdrawals have a small effect on the balance in 401(k) accounts. We estimate that these withdrawals typically reduce average 401(k) assets at age 65 by about five percent.

This is largely because most households who are eligible for a lump sum distribution when they change jobs choose to keep their accumulated 401(k) assets in the retirement saving system.

Second, as you note, we should be in mind that some individuals might choose to participate in a 401(k) precisely *because* they can withdraw funds if needed for a “rainy day.” Thus, shutting off pre-retirement access might make saving less attractive to certain individuals.

While I am not opposed to tightening withdrawal requirements, probably the best solution is simply to encourage greater retirement, such as through automatic enrollment policies. Others, such as Alicia Munnell from Boston College, have suggested that all firms offering pension plans be required to follow auto-enrollment policies. Policies to increase retirement saving policies might not prevent pre-retirement withdrawals, but they would provide a greater buffer against leakage causing significant harm to retirement security.



**Opening Statement of Senator Sherrod Brown**  
**Finance Committee**  
**Subcommittee on Social Security, Pensions and Family Policy**

**Social Security & the Retirement Crisis**

Retirement security in America has traditionally been thought of as a three-legged stool: Social Security, employer-provided pensions, and personal savings and investment.

The first leg of the “stool,” Social Security, guarantees a modest but stable income during retirement years.

But it’s not just for retirement security. It also provides basic financial security in the face of unexpected tragedy. Social Security provides a vital safety net to the disabled, the orphaned, and widows and widowers – something traditional retirement plans are unable to provide.

The other two legs of the “stool,” personal savings and pension plans, build upon the bedrock of Social Security and allow families to maintain the standard of living they enjoyed while they were working. This protects our seniors but it also allows families to use their resources to buy homes, start families, and pay for education.

Without retirement savings, aging parents become dependent on their working-age children, preventing those children from saving for their own retirement and perpetuating the cycle of economic distress in the retirement years.

Unfortunately, for far too many Americans, Social Security is the only leg left standing.

The percentage of workers covered by traditional, defined benefit plans has been declining steadily over the past 35 years. There are now only some 30,000 private sector defined-benefit pension plans, down from 112,000 in the mid-1980s.

From 1979 to 2011, the proportion of private workers with retirement plans covered by defined benefit pension plans fell from 62 percent to 7 percent.

At the same time, the percentage participating in defined contribution plans, which inherently hold more challenges, increased from 16 percent to 66 percent.

Only half of America’s defined contribution plans have auto-enrollment. At a time when we are told that we are in charge of our retirement futures, only one quarter of American workers have automatic access to a defined contribution plan.

Today, about half of the US workforce is covered by an employer-sponsored retirement plan, meaning that nearly half of Americans are not participating in any employer-sponsored plan.

And that is the larger problem.

Working families are being squeezed from every angle. Wages are stagnant. Home values have plummeted.

And tuition costs for our children are increasing at the time we begin to care for our aging parents.

Today, middle class and low-income seniors rely on Social Security for the majority of their retirement income, while workers aged 50 – 64 are increasingly unprepared for retirement

The challenges facing workers are dire.

The vast majority of economic gains in the last 25 to 30 years have gone to those at the very top of the income distribution in this country.

Middle-class workers have not shared in the economic gains or seen increased income associated with increased productivity and higher corporate profits – meaning costs go up, but the ability to save declines.

The picture gets bleaker when considering racial disparities in wealth. Today, the median wealth of white households is 20 times that of black households and 18 times that of Hispanic households – the largest ratios since the government began publishing this data about 25 years ago.

These factors are why most Americans have saved only a fraction of what they need for retirement. Workers approaching retirement age have an average retirement savings of less than \$27,000.

One third of Americans aged 45 – 64 have nothing saved for retirement at all.

The numbers are no better for workers with a retirement plan. In 2010, 75 percent of Americans nearing retirement age had less than \$30,000 in their retirement accounts.

For minority workers the situation is dire, with a median retirement account balance of \$30,000. Eighty percent of Latino households age 25 – 64 have less than \$10,000 in retirement savings.

These facts illustrate how great the need is for maintaining and expanding Social Security – the only source of guaranteed lifetime benefits on which most retirees can rely.

Social insurance doesn't just provide much needed financial support. It ensures that hardworking middle-class people can retire with dignity.

For the majority of recipients, these modest benefits provide over half of their income — lifting over 22 million Americans out of poverty.

The program is not only retirement insurance, it is family income insurance: One-third of benefits go to children, widows, and the disabled. And one in ten children today lives with a grandparent.

Rather than asking how we should scale back the program, we should be asking ourselves how we can strengthen it – and not by reducing benefits or raising the retirement age.

Maintaining or expanding Social Security is the single most effective thing we can do to prevent poverty and economic ruin for millions of senior citizens, while promoting economic mobility for their children and grandchildren.

The budget debate creates a vacuum that does not take into account the economic impact of Social Security programs.

Yes, Social Security benefit cuts will decrease our ten-year deficit, but such cuts do not consider the impact on seniors, their families which then must support them, and current middle- and low-income workers.

Social Security is not a simple budgetary issue – it is a macroeconomic issue. Shifting the costs from the federal ledger does not resolve our retirement and savings problems.

Social Security reforms should be considered as part of the Finance Committee's examination of the burgeoning retirement crisis. And I see this hearing as an important first step in that direction.

I want to yield to my ranking member, Senator Toomey. The Senator and I may disagree on policy particulars, but we both know that these issues are critical for our country, and I am thankful that he is willing join me in examining and engaging in this critical work.

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**Senator John D. Rockefeller IV**  
**Statement for the Record**  
**“The Role of Social Security, Defined Benefits, and**  
**Private Retirement Accounts in the Face of the Retirement Crisis”**  
**December 18, 2013**

Mr. Chairman, I appreciate that you decided to hold this hearing to bring attention to retirement security. This is an important issue, and it affects every American.

There is no doubt that we are facing a retirement crisis in our country. Experts estimate that Americans’ retirement savings are falling short. Forty-five percent of working-age households have no assets in a retirement account. Of households near retirement, one-third have nothing saved. These figures are staggering and alarming. It is even more concerning, because the group of households near retirement today are the last generation where a majority have a defined benefit pension. Simply put, Americans who are nearing retirement are increasingly unprepared financially to maintain their standard of living and live out their golden years with dignity.

Our Social Security system represents the foundation of retirement security in our country. It is an annuity that everyone has access to. It allows people to earn not only retirement benefits, but also important disability and life insurance benefits that they might not otherwise be able to purchase. This provides families with security and the opportunity to get back on their feet if the primary earner is seriously injured or passes away. Because the system is universal and progressive, Social Security is a way for low-income workers to save for retirement through their contributions when they may not have access to retirement savings plans like 401(k)s through their employers.

Currently, many retirees rely heavily on Social Security. More than 75 percent of low-income households rely on their Social Security benefits for all of their retirement income. In total, about 23 percent of married retired couples and 46 percent of unmarried retirees rely on Social Security for more than 90 percent of their income. This is a tremendous argument for keeping Social Security strong, and looking at ways we can improve benefits while extending the life of the Trust Fund.

We also can’t ignore the impact Social Security has on our economy. For every dollar that is paid out in Social Security benefits, \$2 in economic activity is created. This benefits our local economies, including our small business owners, and means Social Security benefits are an equally or more effective way to stimulate our economy than many of the other policies that promote growth.

For all of these reasons, the conversation about benefit cuts should stop here. We should instead look at how we can guarantee the future of our Social Security system by putting it on a solid financial footing for many years to come, and by making sure that benefits are adequate to meet the needs of retirees, people who become disabled, and families who are faced with the loss of a breadwinner.

Social Security is a fundamental issue that affects the economic security of every citizen. I am pleased that we are having this important discussion about Social Security in the context of overall retirement security, and what actions we can take to increase it.



**STATEMENT FOR THE RECORD**  
**SUBMITTED TO THE**  
**FINANCE COMMITTEE**  
**SUBCOMMITTEE ON SOCIAL SECURITY, PENSIONS**  
**AND FAMILY POLICY**

**On**  
**The Role of Social Security, Defined Benefits, and Private Retirement**  
**Accounts in the Face of the Retirement Crisis**

**December 18, 2013**

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### **Introduction**

On behalf of our members and all Americans age 50 and over, AARP would like to thank Chairman Brown and Ranking Member Toomey for convening today's hearing to highlight the critical role Social Security plays – and will continue to play -- in the lives of millions of Americans, especially given the significant retirement crisis that is looming. The gap between the financial assets Americans will need to acquire to maintain their standard of living in retirement and what they are on a path to acquire is startling and suggests that for millions of today's workers their retirement security is even more likely to depend on Social Security. AARP appreciates the opportunity to testify today on some of the significant issues surrounding the current and future state of retirement security of American workers and their families, and more broadly, on the important contributions Social Security makes to families and to the economy, beyond providing a foundation of retirement income for most Americans.

A major priority for AARP has long been to assist all Americans in accumulating and effectively managing the resources they need to supplement Social Security and maintain an adequate standard of living throughout their retirement years. Unfortunately, both economic and social trends over recent decades, and notably developments affecting employer-provided pensions, have made the necessity of achieving and maintaining an adequate income in retirement more challenging than ever before. The three-legged stool of retirement—Social Security, pensions, and assets and savings—is increasingly tottering on the Social Security leg alone. According to a recent calculation by the Center for Retirement Research at Boston College, the “retirement income deficit” for American households ages 32 to 64 is estimated to be roughly \$6.6 trillion. In fact, 57 percent of workers in 2013 reported that the total value of their entire household's savings and investments (not just for retirement), was less than \$25,000, and 28% had less than \$1,000.

These trends underscore the critical importance Social Security plays, and will play, in the retirement security of both current and future generations of Americans, and the need to have a conversation about the future of Social Security that is separate from political debates about deficit-reduction. Social Security was designed to provide only a foundation of an individual's retirement security and was not intended to be the sole source of income for people who have retired. However, due to shortcomings in other traditional

components of the retirement security framework that help individuals achieve and maintain an adequate level of income for their golden years – employer-based pension plans, personal assets and savings, and affordable health care –for most older Americans, including middle-class families, Social Security is the primary source of retirement income. Moreover, for nearly all Americans, Social Security is the only source of retirement income guaranteed to last a lifetime and keep pace with inflation.

#### **Social Security Deserves Its Own Conversation**

In recent years, proposals have been made to reduce Social Security benefits in order to shrink the federal budget deficit. AARP believes that reducing the nation's deficit and restoring confidence in our budget is important, but we also understand that Social Security is vital to the economic security of older Americans, surviving spouses and children, and the disabled. Social Security is a separate, off-budget and self-financed program with its own dedicated funding source and it is not the cause of our federal deficits. Therefore, AARP strongly opposes cuts to Social Security in order to reduce the federal deficit.

According to the Social Security Trustees, even with no changes at all, Social Security has sufficient income from payroll contributions and assets in Treasury notes to pay 100 percent of promised benefits for the next 20 years, and can continue to pay approximately 75 percent of promised benefits thereafter. Social Security is therefore not in an immediate crisis, but the projected funding gap should be closed.

AARP believes that the current Social Security funding shortfall should be addressed sooner rather than later so that the fundamental structure of the program can be retained and the critical income security it offers to almost all workers and their families can be protected and even enhanced. However, any such changes to the Social Security system must be made within the proper framework of maintaining and improving the retirement security of real people and protecting current beneficiaries who have paid into the program during their working lives.

Social Security deserves its own national conversation that focuses on preserving and strengthening the retirement security of Americans and their families for generations to come. AARP welcomes that conversation and stands at the ready to engage with

Congress, our members and other Americans on ways to strengthen Social Security now and in the future.

#### **The State of Retirement Plans Today**

It is widely accepted today that workplace retirement plans and 401(k)-type plans, including those sponsored by state and local governments, have become the core retirement savings vehicles for the vast majority of Americans. AARP strongly believes that all workers need access to a workplace retirement plan that supplements Social Security's strong foundation for retirement income.

Unfortunately, employer-provided retirement plan coverage in the U.S. private-sector has generally hovered around a modest 50 percent for decades, with larger employers more likely than smaller ones to offer retirement plans. Overall, roughly 78 million American workers (both public and private) do not have access to a workplace retirement plan, such as a pension or 401(k) plan. For those workers who are fortunate to work for employers who offer a workplace retirement vehicle, many of their employers have moved away from providing defined benefit (DB) plans and increasingly offer only defined contribution (DC) plans, such as 401(k) plans. Today, only about 18 percent of workers have DB pension coverage on their current job, compared to 41 percent who have DC plan coverage. While DC plans can be valuable to many, they transfer investment, longevity, inflation, and interest rate risks entirely to the individual, and could make it more likely that an individual would outlive his or her retirement nest egg. As a result of these trends, few individuals adequately save for retirement on their own, and many are currently retired, or will retire, with less than enough money to meet their basic needs, relying on Social Security as their sole source of income in retirement.

In response to this significant problem, AARP has been a strong supporter of proposals such as the Auto IRA, which would help bridge this coverage gap and provide access to a workplace retirement vehicle to tens of millions of American workers. Specifically, this proposal – as well as related proposals recently sponsored in numerous state legislatures – would allow workers without access to an employer plan to voluntarily fund their own individual retirement accounts through payroll deductions. Harnessing the



power of regular, automatic payroll deductions at work can encourage and simplify saving and significantly improve the retirement security of millions of Americans.

In addition to coverage issues, the actual participation rate of workers in private-sector pension plans varies with age, income, education, ethnicity, size of employer and type of employment. Older, better-educated, full-time, better-paid workers are more likely to be plan members than younger, less educated, part-time, lower-paid workers.

In an effort to increase participation rates in 401(k) plans, AARP supported the auto-enrollment provisions in the bipartisan Pension Protection Act. A May 2011 Aon Hewitt study found that “(t)hree in five employers automatically enrolled employees into their defined contribution plans in 2010, up from 24 percent in 2006. For employees who were subject to automatic enrollment, Aon Hewitt’s analysis found that 85.3 percent participated in their DC plan, 18 percentage points higher than those that were not subject to automatic enrollment.”

#### **Social Security’s Critical Role as an Income Source for Millions of Americans**

As a result of the diminishing presence of defined benefit pensions and the volatility of personal retirement accounts and private assets, even those lucky enough to have access to a workplace retirement plan are more likely than ever to find that Social Security is the only guaranteed income stream they will not outlive during their retirement.

Social Security is the only lifetime, inflation-protected, guaranteed source of retirement income that most Americans will have. It is the foundation of retirement security that keeps millions of older Americans out of poverty and allows them to live independently. But Social Security also provides some measure of economic security for families who face a loss of income because of the disability or the death of a wage earner. We often do not think of Social Security as a family income protection plan—but that is exactly what it is.

Picture, for a moment, that you’re a 30-year-old mother of one, with a baby on the way, who learns her husband has just perished in an accident at work. Imagine that, in your grief, you have no idea how you’re going to feed your family and keep a roof over your heads. Now, imagine the relief of discovering a program that will help you support your children until they become adults – all because your husband had earned benefits to

protect the family. That blessing is Social Security, and the family was mine. My father died before I was born. My mother worked incredibly hard as a part-time seamstress, but Social Security survivors' benefits were the difference between eating and not eating in our house.

At the end of 2012, about 57 million people received benefits from Social Security. The majority of these beneficiaries were 36.7 million retired workers. Social Security beneficiaries, however, also included 8.8 million disabled workers, 4.4 million children, 4.3 million widows, widowers, and parents and 2.4 million spouses. In fact, Social Security pays more benefits to children than any other government program. Social Security is also a critically important source of income for millions of children who live with their grandparents. For many of these beneficiaries and their families, Social Security is the one source of income that stands between them and poverty – without it, more than 21 million additional men, women and children would be in poverty.

While the number of beneficiaries who rely on Social Security is enormous, the benefit amount itself is quite modest, and in light of how millions of beneficiaries lack additional significant sources of income, may not be sufficient to maintain their standard of living. Today, half of those 65 and older have annual incomes below \$20,000, and many older Americans have experienced recent and significant losses in retirement savings, pensions, and home values. Every dollar of the average Social Security retirement benefit of a little over \$15,000 is absolutely critical to the typical beneficiary. For older American households receiving benefits, Social Security is the principal source of income for nearly two-thirds, and roughly one third of these households depend on Social Security for nearly all of their income. Reliance on Social Security as a source of guaranteed income only increases as people age.

Social Security benefits are particularly important for women, who, on average, live longer and earn less than men. Women also spend more time out of the labor force or work part-time to care for children and other family members. Fifty two percent of all women aged 65 and older depend on Social Security benefits for 50 percent or more of their family income. Moreover, in 2012, older minorities relied on Social Security for a significant share of their family income. Thirty-four percent of African Americans and 35 percent of Hispanics who are 65 and older depended on Social Security for 90 percent or more of their family income. Finally, the poor and near-poor also rely on Social Security

for a significant share of their income; in 2012, over 60 percent of older Americans who were poor near-poor relied on Social Security for 90 percent or more of their family income.

As I travel around the country, I often hear people age 50+ express their passionate commitment to leaving the world a better place for their children and grandchildren. Recently, I've had the privilege of talking to college students, and they feel just as deeply about making sure their parents and grandparents are secure and independent. Social Security, the young and old understand, is a vital part of an intergenerational compact.

Family members depend upon one another, in daily expressions of intergenerational solidarity. Parents welcome children back to the nest; grandparents help pay for college; sons and daughters care for older or ill relatives – often while still raising their own children.

We hear sometimes that the young and old are rival armies in a struggle over finite resources. That's not what I see. I see family members who depend on each other. I see Americans at different stages in life's journey. Older people help younger people; later, the caregivers become the cared-for.

One day, the young will need the protections of Social Security every bit as much as seniors do today – and perhaps more so. Due to stagnating income, shrinking pensions, escalating personal debt and rising costs for education and health care, workers today are less likely than their parents or grandparents to enjoy the living standards of their working years when they retire. If these trends continue, Social Security will be the main source of income for all but the wealthiest retirees in the future.

#### **Social Security's Contribution to the Broader Economy**

The significant role Social Security plays in the financial security of its beneficiaries is growing. At the same time, the role those benefits play in both the national and state economies is only beginning to be fully understood. A recent report published by AARP, "Social Security's Impact on the National Economy,"

[http://www.aarp.org/content/dam/aarp/research/public\\_policy\\_institute/econ\\_sec/2013/social-security-impact-national-economy-AARP-ppi-econ-sec.pdf](http://www.aarp.org/content/dam/aarp/research/public_policy_institute/econ_sec/2013/social-security-impact-national-economy-AARP-ppi-econ-sec.pdf), examined the impact of the \$774 billion in benefits paid by Social Security in 2012. Social Security's economic impact starts when its recipients spend their benefits on goods and services. The businesses that

receive these dollars use them to pay their owners and employees, purchase additional items to sell, and pay rent, taxes and the other normal costs of doing business. Their suppliers in turn use the revenue that they receive to pay their employees, suppliers, and others.

The report shows that every dollar of Social Security benefits generates about \$2 of economic output. Social Security benefit payments help people keep or find over 9.2 million jobs that generate more than \$370 billion in salaries, wages and other compensation. Benefit payments add almost \$1.4 trillion in economic output (goods and services) to the overall American economy. Perhaps most surprisingly, Social Security benefits result in tax revenues for local, state, and federal governments exceeding \$222 billion, including \$78.9 billion in local and state taxes and \$143.3 billion in federal taxes.

Every state – big and small – feels the effects of Social Security benefits being spent within their borders. Not surprisingly, California, with the largest economy of the 50 states, showed the biggest impact. In California alone, Social Security benefits supported 888,000 jobs, \$147.4 billion in output, and \$8.7 billion in state and local tax revenues. In Ohio, Social Security benefits supported just over 349,000 jobs, \$51.7 billion in output, and \$2.86 billion in state and local tax revenues. In Pennsylvania, Social Security benefits supported 470,442 jobs, \$70.9 billion in output, and \$4 billion in state and local tax revenues.

The results of our report are important to the discussions on how to close Social Security's long-term financing gap. According to the Social Security Administration, the Social Security program will face a funding gap that if left unaddressed will require benefits to be reduced across-the-board by about 25 percent beginning in 2033. Our report found that this cut in benefits--about \$190 billion--would cost the U.S. economy about 2.3 million jobs, \$349 billion in economic output, \$194 billion in gross domestic product, and \$93 billion in employee compensation. Too often, the choice for closing the funding gap facing Social Security is characterized as a choice between harming the vulnerable through benefit cuts and harming the economy through tax increases. In addition to the economic hardship that would be felt by individuals, our report shows that reducing benefits would also have a serious impact on the economy by damaging employment, retail and other spending, and lowering tax revenues for both the federal and state governments.

**Conclusion**

The promise of Social Security has endured for over 75 years. It is a promise that AARP believes embodies our deepest values as Americans – our obligations to one another – our obligations between generations – between parents and children – between grandparents and grandchildren – between those in retirement and those at work – between the able-bodied and the disabled. And AARP firmly believes that this promise must continue to endure as Social Security will continue to play a critical role in the lives of future generations of Americans.

AARP would like to thank Chairman Brown and the Sub-Committee for the opportunity to share our views and those of our members on the important role Social Security plays, and will play, in the lives of both current and future generations of Americans. We look forward to working with you and the other members of this Committee to ensure that any modifications to Social Security are done in a way that is consistent with the needs and wants of the American people.



**Sen. Ron Wyden**  
**Senate Finance Subcommittee on Social Security, Pensions, and Family Policy**  
**Questions for the Record**  
**12.18.13 Hearing: The Role of Social Security, Defined Benefits, and Private Retirement**  
**Accounts in the Face of the Retirement Crisis**

**Introduction**

According to a recent calculation by the Center for Retirement Research at Boston College, the "retirement income deficit" for American households ages 32 to 64 is estimated to be roughly \$6.6 trillion. In fact, 57 percent of workers in 2013 reported that the total value of their entire household's savings and investments (not just for retirement), was less than \$25,000, and 28 percent had less than \$1,000.<sup>1</sup> Retirement savings are yet more meager, with even *near-retirees* in surprisingly bad shape. According to recent research by the National Institute for Retirement Security, the median balance in all retirement accounts by near-retiree households age 55-64 is only \$12,000.<sup>2</sup>

"Working longer" is a common mantra, but there are many reasons not to place our faith in that as a solution for all. Research studies consistently find that about 70% of older workers plan to work past normal retirement age to boost their retirement income, but in fact most retire. Real life intervenes: layoffs, health problems, family caregiving responsibilities, age discrimination, and other realities may stymie those plans. "More than half (54%) of retired oldest Boomers did so earlier than planned, citing health issues and job-loss as the two top reasons for doing so."<sup>3</sup>

As your questions indicate, there are many problems with our current pension/retirement savings system, and they are interrelated. First, over the past 25 years, employers have retreated from their traditional role in helping to provide employees with a defined benefit retirement plan. Those who used to offer traditional-style defined benefit plans have either terminated them and replaced them with 401(k)-style defined contribution plans -- shifting all of the risk and often the funding obligation to employees -- or have cut benefits, frozen accruals or, as now, are engaging in "pension derisking" (see below). In addition, nearly half of all employees don't have access even to one of these less secure workplace savings plans, and those who do are not accumulating enough for retirement. Many have had to use their retirement savings before retirement, especially those hard hit by the recession. All of these deficiencies raise questions about how we can leverage our current level of retirement tax expenditures to increase retirement preparedness for all Americans.

<sup>1</sup> R. Helman, M Greenwald, et al., The 2013 Retirement Confidence Survey: Perceived Savings Needs Outpace Reality for Many 17 (EBRI, Mar. 2013), available at [http://www.ebri.org/pdf/briefspdf/EBRI\\_IB\\_03-13.No384.RCS1.pdf](http://www.ebri.org/pdf/briefspdf/EBRI_IB_03-13.No384.RCS1.pdf).

<sup>2</sup> N. Rhee, *The Retirement Savings Crisis: Is It Worse Than We Think?* 11 (2013), available at [http://www.nirsonline.org/storage/nirs/documents/Retirement%20Savings%20Crisis/retirementsavingscrisis\\_final.pdf](http://www.nirsonline.org/storage/nirs/documents/Retirement%20Savings%20Crisis/retirementsavingscrisis_final.pdf).

<sup>3</sup> See e.g., Metlife, *The Oldest Boomers: Healthy, Retiring Rapidly and Collecting Social Security* 4 (May, 2013) <https://www.metlife.com/assets/cao/mmi/publications/studies/2013/mmi-oldest-boomers.pdf>.

We need to take steps to preserve the pensions that remain, and create new approaches that will broaden access to a decent retirement income. AARP appreciates your questions, and we welcome the opportunity to talk more in depth with you and your staff about these critical issues.

1. Pension law requires that pension plans and retirement plans be managed solely for the benefit of plan participants. The contributions American workers make into these plans are not supposed to be used by employers or Wall Street to improve a company's bottom line. Yet I'm reading reports of some of America's biggest companies essentially looting their pension plans to finance executive parachutes and downsizing, and to increase their profits. This type of behavior is unacceptable at a time when workers in Oregon and across the country are facing the threat of pension cuts.
  - Which regulations are being exploited by these companies in carrying out these sorts of actions?
  - Do changes need to be made to pension law to better protect American workers from companies using their pension funds for their benefit instead of the benefit of their employees?

Exploitation of various tax code provisions to increase financial profits and executive compensation has been an ongoing problem with the voluntary retirement system. Indeed, one of the main reasons for the enactment of ERISA was the use of pension assets to finance corporate operations in the Studebaker debacle.<sup>4</sup> Although passage of ERISA and its related tax provisions initially made this more difficult, amendments to these provisions and a shift in the types of retirement plans have raised new issues. Indeed, instead of being administered for the benefit of participants and beneficiaries, employee benefit plans have in many cases become a method to manage corporate earnings.

Below, we provide some examples of the methods by which pensions legally use the tax code and pension laws to achieve their goals.

*Cutting Rank-and-File Pensions and Retiree Benefits  
To Increase Corporate Earnings and Finance Executive Compensation*

Cutting the amount of pension and other retiree benefits reduces the obligations shown on the balance sheet. As a result, the company balance sheet shows a decrease in liabilities and an increase in corporate earnings. Recent changes to FASB accounting rules may be encouraging reductions because the newer rules require companies to place pension and retiree benefit obligations on their balance sheets, thereby highlighting liabilities.

Moreover, executives have every incentive to cut pension and retiree benefits because executive pay is tied to earnings performance. Higher corporate earnings are interpreted as higher performance, which means higher executive pay.

Higher executive pay enables executives to defer more money into non-qualified deferred compensation plans. These plans are unfunded and therefore create significant corporate liabilities. On a corporate balance sheet, these unfunded liabilities are captured in the same line as regular pension liabilities. Consequently, rank-and-file pensions do not necessarily cause

<sup>4</sup> See J. Wooten, 'The Most Glorious Story of Failure in the Business: The Studebaker-Packard Corporation and the Origins of ERISA, 49 Buff. L. Rev. 683 (2001), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=290812](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=290812).

growing pension liabilities; instead, unfunded executive deferred compensation plans cause the growing pension liabilities.<sup>5</sup> In order to reduce these obligations, companies further reduce rank and file employee benefits, resulting in a cycle of cuts to rank and file benefits.

*Transfer of Risk (or "Derisking")*

Recently, companies that haven't already replaced their defined benefit (DB) pensions with defined contribution (DC) plans are pursuing legal loopholes that enable them to get out from under the funding and volatility risk of sponsoring a DB pension more cheaply than they could under standard plan termination procedures. A plan that undergoes a standard termination is required to be fully funded, and the plan participants have many legal protections under ERISA, including insurance by the Pension Benefit Guaranty Corporation (PBGC). With "derisking," however, there is no plan termination. Instead, the plan pays a private insurance annuity provider like Prudential to assume responsibility for making the annuity payments to certain groups of participants, and may even offer groups of participants the option to cash out their pension for lump sum payment. The plan saves money by not having to be fully funded, by enticing participants to take actuarially less valuable lump sums than the annuities they've been promised, and by saving on PBGC premiums and other per capita costs such as recordkeeping.

The Pension Protection Act of 2006 (PPA) and the Moving Ahead for Progress in the 21st Century Act (MAP-21) made this transfer of risk much less expensive for companies. The higher interest rate assumptions enacted in the PPA, enhanced by the interest rate averaging provisions of the MAP-21 enacted in 2012, mean that plans can offer a greatly discounted lump sum amount.

Lump sum offers, *especially* to retirees in pay status, cause the greatest alarm for AARP because they tempt participants to accept a smaller and less secure form of payment that will likely be an inferior deal compared to their pension annuity. While the purchase of group annuities from an insurance company at least maintains the value and reliable income stream of a pension annuity, it does raise questions about the back-up protections in place if the annuity provider fails.

There are several steps that could be taken to greatly reduce these transfers of risk at the expense of participants. First, AARP believes the IRS should reconsider and revoke two private letter rulings it issued in 2012 granting companies the ability to partially "derisk" their pension plans, until it (and Congress) can assess the situation for future transactions. Moreover, AARP has also called on the Department of Labor to establish clear rules requiring plan fiduciaries to observe their safest annuity obligations, and to require contracts with insurance annuity providers to contain provisions that replicate ERISA protections to the extent possible. AARP has also asked DOL to require plans that want to offer lump sum buyouts to provide clear and complete disclosures, make independent, non-conflicted, objective advice available and take extra steps to prevent and mitigate against undue pressure being placed upon those offered the buyouts. Plans should also be required to keep the surviving pension plan adequately funded.

*Employer Stock*

The use of employer stock in defined contribution plans is another method by which companies use the tax code to enrich corporate coffers. Those employers who issue stock frequently use employer stock in two ways: first, the stock is used as the employer contribution, and second it is used as an investment option for employees.

<sup>5</sup> See E. Schultz, *Retirement Heist 102* (2012).



Unlike defined benefit plans, which prohibit an investment of more than 10% in employer securities, there is no such limitation for defined contribution plans. For those employers that use employer stock as a "match" in a 401(k) plan they are able to pay the match using non-cash assets. Employees of course bear the investment risk. As we all remember, when ENRON, WorldCom and Bear Stearns imploded, employees not only lost their livelihoods but their retirement savings.

Moreover, employees have less protection under ERISA for employer stock than with other investment options provided to them. Courts have held that under the *Moench* presumption, named for a 1995 Third Circuit case, a plan fiduciary's decision to continue offering company stock as an investment option is considered consistent with ERISA, unless the plaintiff can show that the fiduciary knew or should have known during the relevant time period of an imminent corporate collapse or other dire circumstances. The issue of when this presumption should be applied is currently before the Supreme Court.<sup>6</sup> In essence, if a plan, by its terms, requires employer stock to be used in a defined contribution plan, then employees cannot challenge it as an investment choice. There are several ways in which the use of employer stock can and should be limited, for instance by limiting the proportion of employer contributions comprised of stock, or by permitting an employer to use employer stock either as the match or as an investment option, but not both.

For a company and shareholders, there are other potential tax benefits to using employer stock in certain types of retirement plans. If a company meets the requirements of employee stock ownership plans (ESOPs), the shareholders and the companies reap certain benefits. Besides deducting the company stock contribution to the retirement plan similar to any other contribution to a qualified plan, the shareholders of certain corporations can defer recognition of gain on the sale of employer securities to an ESOP; in at least three circumstances, stock dividends themselves also are deductible; and under certain circumstances, the employer may deduct a higher percentage of employer contributions to an ESOP than the general profit-sharing or stock plan.

### *Bankruptcy*

Bankruptcy of an employer raises a multitude of issues concerning employee payments and the benefit plans, themselves. In the event a company files for bankruptcy, workers' wages and employees' pensions are currently considered the fourth and fifth priorities, respectively, with other creditors higher in line to be paid. Moreover, the wage priority and contribution priority share a dollar cap, and are both tied to services performed 180 days before the date of the filing of the petition, or the date of the cessation of the debtor's business, whichever occurs first. Thus, the priority claims for wages and benefits are aggregated so that there is little that the employees are guaranteed before the remainder of the claims become unsecured. All unsecured prepetition claims that are not granted a specific priority are treated as general unsecured claims, which generally are not paid until all priority claims are fully satisfied. Bankruptcy courts have also left the PBGC without much recourse: the PBGC's claims are not entitled to priority in bankruptcy either.

2. **A lot of what we've done over the last decade or so is to encourage folks who can already afford to invest more, to invest more. For example, we have increased the**

<sup>6</sup> *Dudenhoefer v. Fifth Third Bancorp*, 692 F.3d 410 (6th Cir. 2012), *pet. for cert. granted*, No. 12-751 (2013).

limits on annual contributions and created and permanently extended the “catch-up” provision.” These measures seem more likely to benefit higher income individuals who have a much easier time saving for retirement.

- What can be done to better encourage those who most need to save to do so? As you know, middle class workers receive a significantly smaller incentive – a smaller tax benefit – to save since their marginal tax rates are lower than upper income workers.
- Under current tax law, if a high income earner like me deposits \$100 into a 401(k), I would receive a tax benefit of at least \$30, holding all else equal. If the same \$100 deposit is made by a low-income worker, her tax benefit is likely to be less than \$10. Is this incentive to save is equitable, and is the tax expenditure appropriately targeted?

Within the existing framework of our voluntary pension system, AARP believes that a well-constructed fabric of tax and pension rules could help improve coverage and adequacy of retirement savings.

The current level of tax incentives should be preserved, but some changes should be considered to enhance the retirement preparedness of more Americans, especially those who are saving the least. The inadequate retirement savings balances of middle and lower-income workers is the product of several problems, only one of which may be that tax incentives for lower-bracket workers are not powerful enough.

The biggest problem is that nearly half of employees have no retirement savings plan at all available to them in their workplace. Automatic payroll deductions from employees' paychecks have proven to be the most efficient and effective method to helping employees build retirement savings. Where plans are available, automatic enrollment and auto-escalation features further increase the numbers of employees who take advantage of these workplace savings opportunities. Thus, ensuring that as many workers as possible have access to tax-deferred plans at their place of work is a critical piece of solving the retirement savings crisis. There are several ideas for ways in which this might be done:

- Automatic Payroll Deduction plans: Proposals such as those previously offered by Sen. Bingaman and Rep. Neal would require businesses that do not offer a retirement plan to make payroll deductions available to employees and to direct those deductions to a private and portable IRA.
- Collective defined contribution plans: These innovations propose to limit the cost and risk for employers while at the same time giving employees many of the benefits of defined benefit plans.
- "State 401(k)s": These authorize private sector workers who have no retirement plan at work to build retirement savings in the state's public pensions plan.

All of these ideas and others could maximize the number of employees with access to workplace retirement savings accounts.

AARP believes that the total amount of tax expenditures currently devoted to helping people build retirement income should not be reduced. Rather, we should preserve those expenditures but also restructure them to be more effective and give more help to those who need it most. The current tax preferences received by *employers* to encourage them to offer and maintain retirement plans such as defined benefit pensions and 401(k) savings plans should not be diminished, although they could be conditioned on behaviors that do not exploit plan assets or

plan participants. We also think that it is important to maintain tax breaks for *individual workers* to encourage them save for retirement, whether in 401(k)s, IRAs, or new vehicles. However, we would favor restructuring the saving incentives to better target them to low- and middle-income savers.

In particular, the Saver's Credit, which is intended to provide a match of sorts to lower-income savers, could be expanded and reformed by expanding the income limitations on eligibility and eliminating the "cliffs" in the credit (phasing out the credit gradually as income increases), making it refundable, providing a more robust benefit to those who are less likely to save, and directly depositing the credit into the retirement account. A better Saver's Credit would not only better encourage retirement savings, but it would also do a better job of helping individuals build retirement assets. Savings from eliminating tax exclusions and deductions could help finance the increase cost of an improved Saver's Credit.

One additional issue that has been greatly overlooked by pension policy is the need to update spousal protections in defined contribution world. Currently, spousal pension rights are only protected in defined benefit plans. Yet, although 401(k)s and IRAs now dominate people's retirement assets, there are virtually no protections for spouses, including surviving and divorced spouses. The spousal pension rules should be updated to mirror, as much as possible, the spousal protections for traditional defined benefit pensions.

3. Each year, American workers deposit \$175 billion into defined contribution plans, and their employers add almost another \$120 billion in matching contributions for a total of \$295 billion in annual savings for retirement. Yet, over 25 percent of households with a DC plan for retirement have used all or some of their savings from those accounts for non-retirement needs, amounting to over \$70 billion in annual withdrawals. Despite the current unemployment situation, a recent study suggests that only 8 percent of those who have breached their retirement accounts have taken early distributions because they lost their jobs. The vast majority of those making hardship withdrawals are doing so to avoid eviction, pay medical bills or educational expenses, or meet other obligations. With the decline of the more stable and certain benefits of traditional pensions, I am concerned about the effect that early distributions have on the resources available to American workers once they retire. While I understand and appreciate that workers need to know that they can access their savings in an emergency in order to encourage their participation in retirement plans, I am also concerned that the relative ease with which they can draw down those savings may create a retirement crisis in the longer term.
  - With that in mind, I would ask the panel, if they were in my shoes on the Finance Committee, whether there is more we can do to reduce leakage from retirement savings accounts without inadvertently discouraging worker participation.

As your question indicates, public policy on the problem of leakage has attempted to walk a difficult line between preservation and participation. The concern is that if contributions are locked up and cannot be accessed until retirement, participants will be less willing to contribute to those accounts. On the other hand, if pre-retirement access is too liberal, the accumulated retirement funds that employees worked to save, and that the taxpayers subsidized, may not be there by the time the employee retires. According to a recent report by EBRI, about 55% of those who took a lump-sum payment after leaving their job did not roll all of it into tax-qualified

savings.<sup>7</sup> During the financial crisis and consequent recession, there is evidence that many midlife and older workers who lost their jobs and have faced discrimination in trying to find reemployment have depleted their retirement savings to pay their housing and living costs.

Consequently, AARP agrees that, provisions allowing early withdrawal of funds from tax-preferred retirement savings accounts for nonretirement purposes undermine the purpose of encouraging saving for retirement. Withdrawals of funds from all retirement vehicles should be restricted. However, as long as contributions to supplemental retirement savings accounts remain *voluntary*, measures that go too far in barring pre-retirement access may indeed discourage participation. There are different exceptions to early withdrawal penalties depending on whether the early withdrawal is from a tax-qualified retirement plan like a 401(k) or an IRA. Some of the current exceptions to the imposition of penalties could possibly be tightened. AARP would be happy to work with you to explore balanced solutions.

AARP has long-supported measures that would strongly encourage pension participants and DC account holders to take their benefits in the form of an annuity that provides a lifetime stream of income rather than as a lump sum. We also support proposals to require 401(k) sponsors and service providers to express account balances in the form of a lifetime income stream rather than simply as an account balance.

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<sup>7</sup> C. Copeland, "Lump-Sum Distributions at Job Change, Distributions Through 2012, 34 *EBRI Notes* 8 (Nov. 2103), available at [http://www.ebri.org/pdf/notespdf/EBRI\\_Notes\\_11\\_Nov-13\\_LSDs-WBS.pdf](http://www.ebri.org/pdf/notespdf/EBRI_Notes_11_Nov-13_LSDs-WBS.pdf).

*Testimony  
of*

**John Sweeney  
Executive Vice-President, Fidelity Investments**

*Before a hearing of the*

**Senate Committee on Finance  
Subcommittee on Social Security, Pensions and  
Family Policy**

**December 18, 2013**

**Opening Statement**

Chairman Brown, Ranking Member Toomey, and members of the committee, good morning, and thank you for this opportunity today.

My name is John Sweeney, and I am an Executive Vice President at Fidelity Investments, responsible for the retirement and investing strategies we develop for the investors we serve. At Fidelity, we have the privilege of helping more than 23 million people save for their financial goals, including retirement through workplace and individual savings vehicles such as 401(k)s and IRAs.

Fidelity takes very seriously the responsibility to help ensure that our investors are well prepared for key life events. Like you, we want to help people be more confident, make clearer decisions and achieve better results for their families when it comes to retirement. And at Fidelity, we are passionate about sharing our expertise and insights to accomplish that, from providing basic education and guidance on how and where to save ...to working directly with investors to help them gain better control and understanding of their investments, Fidelity has a deep understanding of what will help Americans be ready for retirement and to meet other financial goals.

Given our position as the nation's leading provider of retirement services, Fidelity also has a solid understanding of what elements of the nation's private retirement system are working well, and what needs improvement. I am happy that I have the opportunity to share some of these insights with you today.

**A comprehensive approach and solid foundation is needed.**

When investors ask themselves “How prepared am I for retirement?”, they consider a spectrum of savings vehicles, including Social Security, pensions, personal savings, home ownership and health care, among others. While each area has its challenges, I believe policymakers are in a position to help ensure we build on the strengths of our public and private systems and not overlook hidden opportunities (like the positive impact private retirement savings has on economic growth). A recent study released by the American Benefits Council, the American Council of Life Insurers and the Investment Company Institute notes that retirement assets provide more than \$20 trillion in private investment capital in American businesses, with more than \$5 trillion coming from employer-sponsored defined contribution accounts.

When we at Fidelity think about the role that our products and services play in the overall success of the private retirement system, we think about four key stakeholders:

- Government, which provides Social Security, Medicare and rules and oversight of the private retirement savings system
- Employers, which provide workplace benefits to their workers, including retirement savings plans and health savings accounts
- Individual Investors, who are making decisions about how they will save and invest now and spend later to cover their family’s financial needs

- Financial Service Providers, like Fidelity, which offer a range of workplace savings plans, investment options, financial guidance and advice, and other services to companies and their employees.

All these parties must work together in order to have a sustainable and stable retirement system. In addition to meeting individual financial goals, the success of the American retirement system is a critical component of a healthy economy. So the earlier we can begin to implement positive changes in the system, the more impactful they will be for future generations of retirees. Success in retirement and other long-term financial goals requires a long-term view, and we applaud the Committee for exploring these critical issues.

First, the good news. Workplace retirement savings plans continue to be the foundation for America's private retirement savings. While it was created as a supplement to other retirement savings, our defined contribution system is working well for many people, provided they:

- 1) Enroll early in their workplace plan;
- 2) Save consistently at sufficient levels and increase their contribution rate as their salary grows;
- 3) Diversify their investments in an age-appropriate , diversified asset mix, consistent with risk tolerance and financial situation; and
- 4) Stay engaged with their plan – sticking with it through up and down markets, and not taking out a loan or cashing out when they change jobs.



Our latest data from Fidelity recordkept workplace plans show that for those participants who have been enrolled in a plan and continuously saving for 10 years, the average account balance has reached \$223,100, up from \$53,400 ten years prior – an annual increase of more than 15%. And according to EBRI, for those just entering retirement who have both a 401(k) and IRA, the average combined balance is just shy of \$400,000 which speaks to the power of saving through both vehicles. These underscore the power of consistent savings through varied markets and through multiple accounts.

That said, we know that saving is not always easy. Recent research we conducted underscores the challenges working Americans face. I'd like to share with you some of these results and the suggested steps that should be taken to improve retirement preparedness.

#### **Measuring the state of retirement of working Americans**

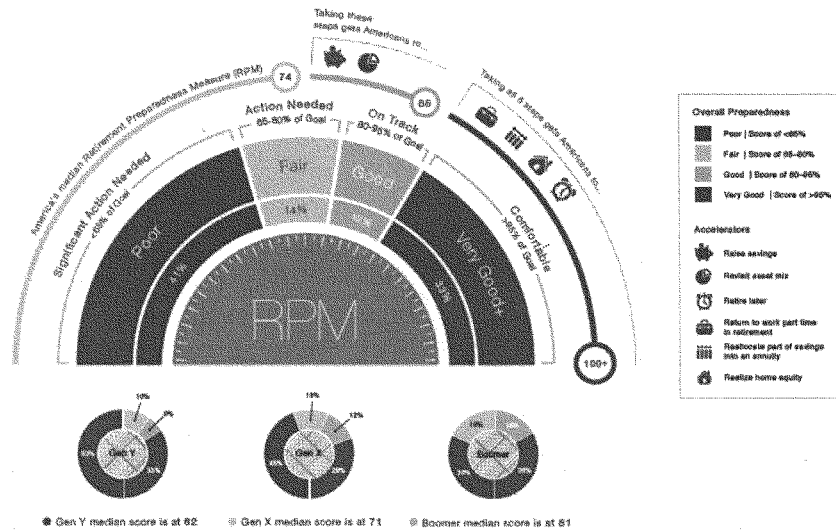
##### **1. Retirement Preparedness Measure: Half of Americans at risk of not covering basic living expenses**

We regularly assess how American households are preparing for retirement to secure a broad understanding of the state of retirement savings. This year, for the first time, we analyzed those survey results using various retirement spending targets to help us better understand levels of retirement preparedness. The results were illustrative but also sobering – while the combination of employer-sponsored and individual retirement accounts has produced many investors who are on track to have a healthy retirement, it

also showed what we are all concerned about; that 55% of working Americans are in fair or poor condition when it comes to being able to cover all of their estimated retirement expenses.

Our analysis allowed us to look both within and across generations of working American households and categorize segments into four numeric categories based on an individual's ability to cover estimated retirement expenses, even in a down market. Let me explain the results at a high level.

- One third or 33% were in the Dark Green: these households are on track to cover at least 95 percent of estimated retirement expenses
- An additional 12 percent were Green – on track to cover 80-95. This group will cover estimated essential retirement expenses but may lack funding for discretionary expenses.
- 14% were Yellow – on track to cover only 65-80 percent of estimated retirement expenses
- And 41 percent were in the Red – on track to cover less than 65 percent of estimated essential expenses – significant adjustments to their anticipated lifestyle are likely.



## 2. Retirement Preparedness Measure: Younger Generations Face Major Challenges to Prepare for Retirement

When we look at the results by generation, we see some significant differences:

- Many Baby Boomers are actually doing well and the median Baby Boomer household is on track to reach 81 percent of their retirement spending goal. The challenge here is that for those Boomers lagging behind, they have little time to improve their situations. The most impactful step these Boomers can take is to continue to work and delay retirement.
- On the other hand, younger workers are not doing as well and face major challenges.
- Gen X is yellow ... on track to reach 71 percent of their goal.

- Gen Y investors are falling significantly short and the median household is in the red at 62 percent.

While the young investor has the benefit of time on his/her side, and changes in behavior at this point in their working career can be very impactful, today's young investor faces a playing field where the goal posts have been moved down the field. With medical advances, we can expect this generation to live longer than their parents' generation, and young investors have expressed doubt that Social Security will provide them with the level of income in retirement that it provided to their parents.

In short, the younger generation will be forced to self-fund more of their income in retirement than their parents had to. The youngest workers in our economy should expect to work longer than age 65, will need to save more, and should start earlier despite the very real and immediate demands, including student debt, mortgages and a greater responsibility for their healthcare costs. At the same time, they should be confident that the equity markets will fuel their retirement balances and is the most likely way for their portfolios to outpace inflation.

#### **What can we do?**

Like any statistical analysis, there is a wide range of behaviors; some people are following the recommended path, making decisions to forgo short term spending in favor of saving for the long-term. But there are people at all income levels who are electing not to save.

At Fidelity, people come to us to make some of the most complex, difficult decisions of their lives. We have an obligation to do everything in our power to help them – to get more people to a place where they are more likely to achieve a comfortable retirement. And the earlier we can help them, the better.

So what can and should we do to improve on these scores? I'll highlight three.

**First raise savings now:** We know for individuals, especially younger investors, that the most powerful way to improve readiness is to increase savings levels – even if it is by a small amount. Our research shows that for a 25 year old earning \$40,000 a year, increasing savings by 1 percent a year can mean up to \$300 a month more in retirement income.

Employers and service providers like Fidelity are working toward these goals in a number of ways:

- Increasing the adoption of plan design features such as automatic increase programs – which allow workers to automatically increase savings levels annually unless they opt out.
- Changing the way employers structure how they match retirement savings can encourage even greater levels of personal saving.
- Innovating on the design of retirement plans to focus on “better outcomes” for participants. This will aim to have plans target a worker’s optimal savings

outcome. In other words, plan design around the paycheck it can provide in retirement, rather than how much you can save while working.

**Second, double the default deferral rate.** For policymakers we feel the time is now to build on the strength of the Pension Protection Act and enhance its best features. It has been seven years since its passage and while automatic enrollment works – a default rate of 3 percent is too low. Fidelity believes in a target goal of saving 10-15 percent of your salary annually and to get to this level a minimum of a 6% safe harbor auto enrollment is needed along with annual auto increase of 1%. Policymakers can help by increasing the default deferral rate to at least 6 percent and requiring defaulting into auto-increase programs. Doing so now could mean a world of difference for the younger generations.

Our research indicates that there is little decline in participation rates when workers are defaulted into higher automatic contribution rates of 6%. Employees are looking for guidance on when to enroll in their plan, how much of their salary to contribute and they turn to their employer and plan record keeper for that very critical information.

We also know in our discussions with plan sponsors and employers that their defined contribution plans are not designed to replace all of a retiree's income in retirement. The defined contribution plan has become the primary retirement savings vehicle for many working Americans, but they need to understand that in addition to their employer sponsored retirement savings plans, workers will be required to save in an Individual Retirement Account outside of the defined contribution plan in order to confidently achieve the retirement savings they hope to have. Continuing support for these vehicles

and their tax incentives is critical – especially for the millions of workers in small businesses.

**Finally, more, not less education and guidance is needed for working Americans.**

Right now, people are overwhelmed with information and choices. As I've said, they're increasingly on their own financially. Most savers are middle- and low-income Americans. The demand for education and guidance is up dramatically for these workers since the financial crisis, and our stats show that workers who engage in a retirement planning session – either online or on the phone - increase their deferral rate by an average of 5 to 6 percentage points, and are 3.2 times less likely to cash out of their workplace savings plan when they leave their employer.

We take great pride in making retirement planning resources accessible to as many people as possible. But potential rulemaking by the Labor Department in this area could significantly curb the ability of millions of low-and middle-income workers to gain fundamental financial education and guidance they need to improve their financial security. Now more than ever, policymakers need to ensure steps are taken to bolster, not hinder the ability of working Americans to receive education and guidance about their financial future. And so, we encourage this committee to work with the Administration to ensure people can continue to have wide access to the kind of resources they need to make good responsible decisions for themselves and their families.

**Closing Statement**

In closing, while our research shows major challenges for many Americans, steps can be taken now which will pay significant dividends down the road.

Congressional leadership has shown that when we work together to increase savings rates in the workplace, we can help more Americans be better prepared for retirement and the challenges that lie ahead.

Fidelity is committed to partnering with you and members of your committee as you work toward solving these issues.

Thank you again for the opportunity to appear today and share our thoughts on how to help working Americans better prepare for retirement. I am pleased to take your questions.



**Sen. Ron Wyden**  
**Senate Finance Subcommittee on Social Security, Pensions, and Family Policy**  
**Questions for the Record for John Sweeney**  
**12.18.13 Hearing: The Role of Social Security, Defined Benefits, and Private Retirement**  
**Accounts in the Face of the Retirement Crisis**

1. Pension law requires that pension plans and retirement plans be managed solely for the benefit of plan participants. The contributions American workers make into these plans are not supposed to be used by employers or Wall Street to improve a company's bottom line. Yet I'm reading reports of some of America's biggest companies essentially looting their pension plans to finance executive parachutes and downsizing, and to increase their profits. This type of behavior is unacceptable at a time when workers in Oregon and across the country are facing the threat of pension cuts.

- Which regulations are being exploited by these companies in carrying out these sorts of actions?
- Do changes need to be made to pension law to better protect American workers from companies using their pension funds for their benefit instead of the benefit of their employees?

**Answer :** We are not aware of the exact instances referred to here and the above question could encompass issues affecting corporate and public pension plans. A number of offenses have been outlined in various articles and press reports. It should be noted that many of those offenses have now been prohibited or made less desirable by pension reform legislation. Companies cannot directly spend pension funds on operating expenses. Companies cannot take money out of a pension fund except to pay the pension plan benefits to employees. Companies cannot reduce an employee's benefit (but they can freeze it to stop it from growing further). Companies used to be able to increase the benefit promise without funding for it, but current law does not permit benefits to be increased if the plan is already underfunded.

We find that investors need help evaluating how the choices available to them may affect the probability of successfully navigating their retirement. In particular, it is very difficult for workers to compare the value of a lump sum payment to a stream of monthly payments for life. Another challenge for workers is determining the appropriate resources required to fund their retirement. Expenses in retirement are difficult to estimate, the inflation component is often overlooked, and it is difficult to pull together pensions, Social Security, and income from all savings sources.

At Fidelity, we work hard to offer investment education to help participants understand these principles, and to understand the threats and risks to their retirement security. Once employees understand the value of retirement assets and income, they will be better equipped to understand and respond to changes in their corporate sponsored pension plans.

2. A lot of what we've done over the last decade or so is to encourage folks who can already afford to invest more, to invest more. For example, we have increased the limits on annual contributions and created and permanently extended the "catch-up" provision." These measures seem more likely to benefit higher income individuals who have a much easier time saving for retirement.

- What can be done to better encourage those who most need to save to do so?

**Answer :** One of the major challenges to improving retirement security is increasing the savings rate among Americans of all income levels. At Fidelity, we are constantly striving to increase the adoption of auto features, encourage employers to structure their match to encourage even greater levels of personal saving, and innovate on plan design to focus on better outcomes for participants with access to these features.

Policymakers can help by using the power of inertia to put employees on a better path to retirement security by increasing the default deferral rate to at least 6% and requiring default into auto-increase programs. Setting a floor of 6% should be the very minimum of what we can do to get employees to save more. Our research shows investors in all income sets will save at higher levels if automatically enrolled in the first place. Policymakers should further incent employers to adopt auto increase programs by easing fiduciary and testing burdens and expanding PPA safe harbors. Finally, expanding and making the Saver's Credit refundable would grow savings among lower income workers by increasing the number of workers eligible for the credit, enabling direct deposit into a qualified retirement vehicle and providing a matching credit amount.

- Under current tax law, if a high income earner like me deposits \$100 into a 401(k), I would receive a tax benefit of at least \$30, holding all else equal. If the same \$100 deposit is made by a low-income worker, her tax benefit is likely to be less than \$10. Is this incentive to save equitable, and is the tax expenditure appropriately targeted?

**Answer :** By and large across all income spectrums, our investors want and value retirement savings tax incentives. The reduction or redistribution of these incentives could negatively impact savings behaviors, plan formation, and older, lower-income, and "at-risk" workers the most. Studies have shown that lower-income workers would be disproportionately harmed because reducing the tax benefits of retirement savings plans could lead small and mid-size businesses to reduce their employer match or reconsider offering retirement plans to their employees. As a result, fewer workers would have access to workplace plans, disproportionately harming lower-income workers.

Further, we are concerned that some in Washington view retirement savings tax incentives as an expenditure and not a deferral. We think that is short-term thinking that neither takes into account the taxes ultimately paid on those savings nor the investment, capital and economic growth that private retirement savings brings today.

3. Each year, American workers deposit \$175 billion into defined contribution plans, and their employers add almost another \$120 billion in matching contributions for a total of \$295 billion in annual savings for retirement. Yet, over 25 percent of households with a DC plan for retirement have used all or some of their savings from those accounts for non-retirement needs, amounting to over \$70 billion in annual withdrawals. Despite the current unemployment situation, a recent study suggests that only 8 percent of those who have breached their retirement accounts have taken early distributions because they lost their jobs. The vast majority of those making hardship withdrawals are doing so to avoid eviction, pay medical bills or educational expenses, or meet other obligations. With the decline of the more stable and certain benefits of traditional pensions, I am concerned about the effect that early distributions have on the resources available to American workers once they retire. While I understand and appreciate that workers need to know that they can access their savings in an emergency in order to encourage their participation in retirement plans, I am also concerned that the relative ease with which they can draw down those savings may create a retirement crisis in the longer term.
- With that in mind, I would ask the panel, if they were in my shoes on the Finance Committee, whether there is more we can do to reduce leakage from retirement savings accounts without inadvertently discouraging worker participation.

**Answer :** For some participants, a plan loan can be a financial necessity. But loans and hardships can erode retirement savings. Fidelity believes that in order for employees to stay on track and accumulate sufficient assets towards retirement, plan loan restrictions are essential as too many loans can have a significant negative impact on retirement savings. We recently analyzed loan and hardship withdrawal trends – and their impact on retirement readiness – among 20,600 retirement plans and 12.3 million participants nationwide (see attached). What we found is that plan borrowing is still all too common, and borrowers ultimately save less.

There are a range of steps that can be taken to help limit leakage from retirement savings. To that end, Fidelity has supported certain plan design features such as “one loan at a time” limits, a waiting period between loans, and automatically reinstating contributions after hardship suspension in order to help participants keep their savings on track. Restricting the ability of plan participants to withdraw funds and limiting the number of loans available would streamline plan administration and enhance benefit security. We have also supported flexibility with respect to loan repayment and hardship withdrawal rules, which would allow individuals who have terminated employment and have an outstanding loan an extended period of time to repay the loan without incurring income taxes or an early withdrawal penalty. In today’s economy, workers with a financial emergency who take a hardship distribution should not be discouraged from continuing to save for retirement.

## Loans and hardships can erode retirement savings.

For some participants, a plan loan can be a financial necessity. But how does borrowing affect retirement outcomes? It's largely a function of a participant's goals and behavior. Fidelity recently analyzed loan and hardship withdrawal trends—and their impact on retirement readiness—among 20,600 retirement plans and 12.3 million participants nationwide.<sup>1</sup> Here's what we learned.

### PLAN BORROWING IS ALL TOO COMMON.

One in nine participants took a **new loan** in the past year.

Of **new loans**, the average amount participants have taken is \$9,000.



### HARDSHIP WITHDRAWALS OCCUR LESS FREQUENTLY.

2.3% of participants used this option in the last year.

Participants age 35–44 and those making \$30K–\$50K a year are most likely to take hardship withdrawals.



The two most common reasons for hardship withdrawals?



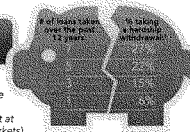
### "SERIAL BORROWING" IS A SAVINGS THREAT.

50% of 401(k) borrowers take just one loan, but the other 50% borrow multiple times.

Overall, 10% of participants who take a loan go on to take a hardship withdrawal.

10% of participants taking a hardship withdrawal later borrow again.

Many participants are required to exhaust all available loans before taking a hardship withdrawal.  
Source: Fidelity Investments data of DC plans present at any time from 2000 to 2012 (excludes tax-exempt markets).



### BORROWERS ALSO SAVE LESS.

Lower deferrals, combined with having money "out of the market," can lead participants way off track.

**6.5%**

average deferral rate  
for participants who  
have taken loans



**8.4%**

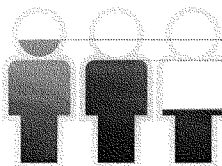
average deferral rate for  
participants who have  
never taken a loan

Borrowers lowered their contributions by an average of 2%.

And those deferral reductions can last a full two years beyond the loan repayment date.

### BOTTOM LINE: RETIREMENT SAVINGS ARE BEING DEPLETED.

Three participants  
who are the same  
age and have the  
same salary and  
asset allocation  
could have very  
different savings  
outcomes.



Hypothetical  
pretax savings  
after 10 years

\$364,000

\$313,000

\$131,000

Participant 1: Took a loan of 30% of his salary and took no loans or hardship withdrawals.

Participant 2: Took a loan of 30% of his salary and a series of loans totaling \$117,000 and kept current with loan payments.

Participant 3: Had a hardship withdrawal of his money and took a series of loans and hardship withdrawals totaling \$130,000.

This is a hypothetical example of pretax contributions; your own account may earn more or less than this example. Taxes are due upon withdrawal. Data as of 6/30/2012.

### HOW CAN YOU HELP?

Loans and hardship withdrawals, though compelling, can leave participants facing financial challenges. Can your retirement plan help participants take steps to control borrowing?



#### ASSESS USAGE

Determine how many participants are seeking loans and withdrawals. Do you rank higher than your industry peers? Have you identified your "serial borrowers"? An intensive education effort may be needed.



#### COMMUNICATE THE RISKS

Make sure participants understand the costs of possible tax penalties, and of reducing or interrupting contributions, and the costs of the loss of potential growth and earnings when their money is "out of plan."



#### MODIFY PLAN DESIGN

A "one loan at a time" limit, a waiting period between loans, and automatically reinstating contributions after hardship suspension can help more participants keep their savings on track.



#### PROMOTE GUIDANCE

Encourage use of the online planning tools, phone consultations, and one-on-one interactions that can help shape better decisions.

For plan sponsor and investment professional use only. Not for use with plan participants.

Unless otherwise noted, data are based on Fidelity's analysis of 20,600 retirement plans and 12.3M participants as of March 31, 2013, excluding nonqualified plans, tax-exempt plans, and plans sponsored by Fidelity Investments for the benefit of its own employees.

Fidelity business data of hardship withdrawals requested from January 1, 2012, to December 31, 2012.

Investing involves risk, including the risk of loss.

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## COMMUNICATIONS

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December 23, 2013

**Statement for: “The Role of Social Security, Defined Benefits, and Private Retirement Accounts in the Face of the Retirement Crisis”**

The American Council of Life Insurers (ACLI), the American Benefits Council (ABC), and the Investment Company Institute (ICI) would like to thank Chairman Brown, Ranking Member Toomey, and the Subcommittee on Social Security, Pensions, and Family Policy for holding this important hearing.

As your committee and other policymakers consider how to help more Americans achieve financial security in retirement, we are pleased to submit for the record a summary of the white paper, “Our Strong Retirement System: An American Success Story.” (The full version of the paper is linked at the bottom of this letter.) With Social Security forming the foundation for retirement income for all workers, the U.S. retirement saving system is robust – formed by employer-sponsored defined benefit (DB) and defined contribution (DC) plans, individual retirement accounts (IRAs), homeownership, annuities, and other saving.

The paper comprises the latest research and up-to-date statistics that illustrate the current U.S. retirement system’s successes in helping Americans at all income levels achieve financial security. Employer-sponsored retirement plans are available to almost 80% of full-time workers, and more than 80% of those individuals participate in their plan. In addition, DC plans are an increasingly popular solution for employers and savers, especially in today’s mobile workforce. With consistent contributions, DC plans allow workers to accumulate significant savings over time. When looking at the combined account balances of near-retirees with 401(k)s and IRAs, the average amount is nearly \$360,000. Assets earmarked for retirement form a major share of households’ total financial assets. As of September 2013, Americans had more than \$21 trillion in retirement assets.

Americans also report a high level of confidence in the 401(k) system, and value the many features and amount of control over their assets provided by these plans. Above all, they overwhelmingly support keeping the current tax incentives, which are important to promote saving for retirement. The paper analyzes a number of recent proposals that would seek to reduce these incentives and finds them deficient in many respects.

As the paper’s research demonstrates, America’s retirement system has grown to better serve each successive generation. Innovations in plan design and various improvements, including automatic enrollment, automatic escalation, and life-cycle investing, help improve retirement security. In addition, there are numerous other enhancements that can further promote retirement security for more Americans. Accordingly, policymakers should seek to build and expand on the existing system, rather than eliminate or destabilize it.

We again thank the Committee for its consideration of this important issue, and look forward to working with the Committee in the future.

###

**About ACLI**

The American Council of Life Insurers (ACLI) is a Washington, D.C.-based trade association with more than 300 member companies operating in the United States and abroad. ACLI advocates in federal, state, and international forums for public policy that supports the industry marketplace and the 75 million American families that rely on life insurers' products for financial and retirement security. ACLI members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance, representing more than 90 percent of industry assets and premiums.

**About the American Benefits Council**

The American Benefits Council is the national trade association for companies concerned about federal legislation and regulations affecting all aspects of the employee benefits system. The Council's members represent the entire spectrum of the private employee benefits community and either sponsor directly or administer retirement and health plans covering more than 100 million Americans.

**About ICI**

The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). Members of ICI manage total assets of \$16.1 trillion and serve more than 90 million shareholders.

**About the Paper**

The paper, "Our Strong Retirement System: An American Success Story," is available on each organization's website:

The Council: [www.americanbenefitscouncil.org/documents2013/strong-retirement120413.pdf](http://www.americanbenefitscouncil.org/documents2013/strong-retirement120413.pdf)

ACLI: [www.acli.com/Issues/Retirement%20Plans/Pages/RP13-006.aspx](http://www.acli.com/Issues/Retirement%20Plans/Pages/RP13-006.aspx)

ICI: [www.ici.org/pdf/ppr\\_13\\_strong\\_retirement.pdf](http://www.ici.org/pdf/ppr_13_strong_retirement.pdf).



## OUR STRONG RETIREMENT SYSTEM An American Success Story

### SUMMARY

DECEMBER 2013

The U.S. retirement system has many components: Social Security provides a strong base, complemented by employer-sponsored retirement plans, IRAs, annuities, and other savings. A growing component of that system is employer-sponsored defined contribution arrangements, such as 401(k) plans. These plans are popular and successful with employees and employers. With consistent contributions over time, defined contribution plans can generate substantial retirement benefits, especially when combined with Social Security. This report brings to bear the most recent statistical data and the results of rigorous academic research to clearly illustrate:

1. **Americans' retirement well-being has improved over time**, as successive generations of retirees have been better off than previous generations.
2. **Access to and participation in retirement plans are both strong**, with almost 80% of full-time workers having access to employer-sponsored retirement plans, and more than 80% of workers with access to plans participating. With further refinements, coverage could be increased to benefit other workers as well.
3. **Defined contribution plans can produce meaningful retirement benefits**, as evidenced by account balances that reflect combined 401(k) and IRA assets accumulated over a full working career. Near-retirees (age 60–64) have on average nearly \$360,000 in their defined contribution accounts and IRAs combined.
4. **The 401(k) is a good fit for America's mobile workforce**, in which workers tend to move from job to job, because these plans are portable. When employees accumulate savings in workplace retirement plans like the 401(k), those assets grow with them when they change jobs.
5. **Americans report high levels of confidence in the 401(k) system**—despite recent market turmoil—and appreciate its many user-friendly features including the tax benefits, the convenience of payroll deduction, their control over their own assets, and the choice of distribution options.

6. **Retirement plan contributions are tax-deferred, not tax-free**, meaning that efforts to raise money by taxing retirement plan contributions upfront are short-sighted and illusory—and could ultimately decrease retirement savings, especially for low-income workers.
7. **Retirement assets constitute a major share of U.S. households' savings and investments**, providing more than \$20 trillion (\$5.3 trillion from defined contribution plans alone) in private investment capital for American businesses.
8. **Innovation and incentives improve retirement security**, as demonstrated by initiatives that are well under way (such as automatic enrollment, automatic escalation, and life cycle investing).

The evidence is compelling: the current retirement savings system is fostering economic security in retirement for Americans across all income levels. Defined contribution plans have grown in importance in U.S. retirement accumulations, rising to be a key component of the voluntary, private sector employer-sponsored system. Defined contribution plans, which offer workers a portable benefit that grows throughout their careers, are a flexible platform for further innovation and improvement. Defined contribution plans are not just “working,” they are strong.

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The American Benefits Council (the Council), the American Council of Life Insurers (ACLI), and the Investment Company Institute (ICI) sponsored this white paper, a compilation of research from a wide range of sources. “Our Strong Retirement System: An American Success Story” is available on each organization’s website.

The Council: [www.americanbenefitscouncil.org/documents2013/strong-retirement120413.pdf](http://www.americanbenefitscouncil.org/documents2013/strong-retirement120413.pdf)

ACLI: [www.acli.com/Issues/Retirement%20Plans/Pages/RP13-006.aspx](http://www.acli.com/Issues/Retirement%20Plans/Pages/RP13-006.aspx)

ICI: [www.ici.org/pdf/ppr\\_13\\_strong\\_retirement.pdf](http://www.ici.org/pdf/ppr_13_strong_retirement.pdf)

**Finance Sub-Committee hearing on "The Role of Social Security, Defined Benefits, and Private Retirement Accounts in the Face of the Retirement Crisis", December 18, 2013 (Senate Recording Studio 4-4977)**

**Virjeana Marie Brown**

I am submitting the following statement to be included in the above mentioned hearing:

I had the opportunity to hear almost all of the above reference meeting and feel strongly compelled to write this letter so that you have an opportunity so see what is really going on in the United States outside of Washington, DC.

First I would like to share a little about myself so that you know where I am coming from and who I am. I am Virjeana (Jeannie) Brown from Belgrade, Montana and I am a full-time, **unpaid** caregiver for my severely disabled granddaughter, Lena Brown. I do not live in the intercity of anywhere, I have a high school diploma and some college, live in a nice neighborhood and am of Scandinavian heritage.

In 2008 my granddaughter was taken from my daughter by Child Protective Services partially due to domestic violence. Lena was in foster care for six months and I fought hard to get her back and went on to adopt her.

Lena is severely disabled and medically fragile. She is on Medicaid. Without Medicaid I could not afford her 4 anti-seizure medications and she could literally die without medical intervention. Lena will have a short life-span because of the numerous health issues she deals with daily. The doctors are unable to tell me what her life expectancy will be, but there is a very real and good possibility that she will not make it out of her teens.

On 2/1/2010, my mother, who cared for Lena so I could work, suffered a mini-stroke. I had to quit, what I felt was, a VERY GOOD paying job (in 2009 made \$31,310) that provided health insurance, retirement, vacation and sick pay as I was unable to place my granddaughter into any daycare facility for care. Daycare facilities are not equipped to deal with complex medical issues and I could not afford a private nurse. Please note that it took me ten years to get to the \$31,310 annual wages and I worked as an Accounting Clerk for Gallatin County, in Bozeman, Montana.

I was faced with a very difficult decision as I was now a full-time caregiver, with a mortgage and no income. I was close to having my house paid off (a Habitat House, hand-up not hand-out), so I made the decision to access my retirement (defined contribution) so that I could finish paying off my house and not become homeless. Contrary to what someone said in this meeting, there is a penalty for accessing these

retirement accounts. The IRS assess a 10% penalty when someone makes a lump sum withdrawal out of their retirement plans.

Once I started to use my retirement of \$31,000 I was required to use all of it before I could get help with energy assistance and food stamps. Now my only source of income is from an adoption subsidy of \$24.83 per day or an average of \$755 per month. This is \$9,062.95 a year for two people. I point this out, because it is clearly much lower than the \$1,000 or \$1,300 average monthly Social Security benefit amount and clearly not "adequate" as Mr. Biggs stated when referring to monthly benefit amounts, especially for those that depend on Social Security for their entire retirement. The adoption subsidy comes out of the same pot of money as SSI. Lena was on SSI until I adopted her in 2009.

I worked and paid into Social Security for 32 years as a single mother raising two children with no child support (I am divorced, children not born out of wedlock). I am only 49 years old and I am very worried about my future as I age. I was fortunate enough to have a "desk job" and I deal with "carpel tunnel" on a daily basis and experience pain and loss of ability to even open a jar without assistance. I have been caring for my granddaughter for 5 years now and I have serious physical issues with my right arm because of caregiving. I need surgery on my right arm and shoulder, but the doctors have decided that we will hold off for a couple of reasons. I do not have anyone who could care for Lena full-time so that I could recover from surgery and there is the concern that I would end up right back where I currently am because I will continue to be the only caregiver for Lena. In the meantime, I continue with physical therapy to mitigate the pain and to allow for maximum range of motion. I also do not have health insurance (I qualify for financial assistance through the local hospital). The Affordable Care Act is by no means affordable to me and Montana did not accept Medicaid Expansion.

Clearly increasing the age of retirement to 69 or 70 is extremely irresponsible, in my opinion. I am in so much pain now, I cannot imagine working that much longer. I struggle wondering how I will make it to age 67 to be able to retire.

I am a representative payee (I have their permission to share this information) for an individual who currently gets \$710.00 for SSI. Starting in January with the not so generous 1.5% increase they will get \$720 a month. Their lot rent in November went from \$260 to \$275. Clearly wiping out any gains. They own their trailer, but if the rent continues upward at a higher rate than COLA, they will become homeless.

In the same trailer court, there is a single, retired woman who gets less than \$660 a month for Social Security (her only source of income) and a gentleman who gets less than \$475 a month for Social Security. These people are not living high on the hog, and are always one disaster away from homelessness. This is the wealthiest country in the entire history and this is how we are treated. This is shameful.

Individuals in this meeting believe that we need to strengthen not only Social Security, but Defined Benefit Retirement Plans and people need to start saving and saving earlier for their retirement. I started in the workforce in 1982 and I was paid \$6.87 (above the then current minimum wage) and the current federal minimum wage is \$7.25. If auto-saving and auto-escalation is one way to fix the retirement crisis, I would then suggest a minimum wage of at least \$15.00. How can people save if they don't even have the money to cover their monthly bills? How can people save when they are upside down on their mortgages? How can people save when they are so far in debt just trying to maintain a conservative standard of living covering the basics of food, shelter, and clothing?

I am concerned with an "auto-savings" program that would be set up as an annuity that would be set-up in favor of Wall Street or investment bankers that can take a higher percentage in "management fees" or use "our" money to gamble. They are after all in the business of making money. As the recent economic crisis shows in my mind, investments in Wall Street are way too risking and the companies playing with "our" money would just use it to their advantage and not ours. Social Security should never be privatized and is the bedrock of retirement and everything possible should be done to expand and strengthen this program and create incentives to bring about more Defined Benefit retirement packages for employees.

I believe that if the cap was removed on all wages, this would go a long way in protecting and expanding Social Security. Capital Gains should also be taxed for Social Security, Medicare and Medicaid. The Consumer Price Index for the Elderly should be used in calculating realistic costs. I believe that Senator Harkin's bill S.567 goes a long way in expanding and protecting Social Security and **is one step of many** that needs to be taken to remedy the retirement crisis and economic injustice faced in this country.

One of the solutions, to offset poverty in retirement, is to offer a caregiver credit for people like me who have sacrificed an income to care for a disabled or elderly person. I spent my savings, I spent my retirement. I will be depending on Social Security in my future. We need to expand Social Security.

It is estimated that there are 11 million un-documented workers in this country. They are paying into Social Security under false social security numbers and will never collect on what they have paid into. There are many being paid under the table in cash. If the House would pass immigration reform, then millions of people would be paying even more into Social Security.

With the policies of the past thirty or so years, the middle class has been gutted, poverty is worse, children and those in low-income situations are starving and homeless. Want to know how to pay for expanding Social Security, creating jobs and helping with an economic recovery (for those outside the financial industry)? Start with closing the loopholes on corporations that allow them to pay little or no taxes and in some cases get a tax refund. Penalize corporations that send jobs overseas and invest in other

economies. Cut the military budget (close Guantanamo) and quit sticking out noses in other countries business. Invest in this country and the people.

I believe the majority, not all, of the Congressmen in Washington, DC are more concerned with re-election, protecting "Corporate Welfare" and selling the average American out. It would appear that many elected officials have forgotten that they are "public servants" elected to do what is in the best interest for the common good and that you work for the American people, not the corporations.

When more Americans realize the "game" is rigged against them because of the policies of the past 30-40 years, and quit feeling shame that they didn't try hard enough or work hard enough, or save enough, they will find their voice again and get really loud. The inequality that is destroying this country needs to be remedied and the Congressmen on this sub-committee have a chance to alter history and start undoing the damage. Congress needs to act now instead of allowing citizens to continue to fall through the cracks as they are now. Above all, please go home and visit with the people in "their" communities (not the fund raising events or in front of your supporters). Quit buying into all the crap from the corporations and economists doing their bidding. We are not in an economic recovery, real people continue to struggle and there is a desperation growing across this once great nation.

I applaud the Congressmen like Senator Sherrod Brown, Senator Tom Harkin, Senator Bernie Sanders, Senator Elizabeth Warren, Senator John Tester, Rep. Keith Ellison, Rep. Raul Grijalva, Rep. Jan Schakowsky (and all the other Progressive Congressional Members) who are fighting for the betterment of this country.

Respectfully submitted,



Virjeana Brown

**United States Senate Committee on Finance  
Subcommittee on Social Security, Pensions, and Family Policy**

Hearing on:

**The Role of Social Security, Defined Benefits, and Private Retirement Accounts in the Face of the Retirement Crisis**

**Wednesday, December 18, 2013, 10:00 AM  
215 Dirksen Senate Office Building**

**Statement for the Record**

**Jack VanDerhei, Ph.D.**  
Research Director  
Employee Benefit Research Institute (EBRI)



The views expressed in this statement are solely those of Jack VanDerhei and should not be attributed to the Employee Benefit Research Institute (EBRI), the EBRI Education and Research Fund, any of its programs, officers, trustees, sponsors, or other staff. The Employee Benefit Research Institute is a nonprofit, nonpartisan, education and research organization established in Washington, DC, in 1978. EBRI does not take policy positions, nor does it lobby, advocate specific policy recommendations, or receive federal funding.

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## Introduction

Measuring retirement income adequacy is an extremely important and complex topic, and the Employee Benefit Research Institute (EBRI) started to provide this type of measurement in the late 1990s with the development of the EBRI Retirement Security Projection Model® (RSPM)<sup>1</sup>, a computer simulation model that projects the financial outcomes for U.S. households in retirement. When we most recently modeled the Baby Boomers and Gen Xers earlier this year (2013), we found that their Retirement Readiness Ratings (or RRRs™, defined for public policy purposes as the probability of having adequate retirement income for standard retirement expenses—housing, food, etc.—plus uninsured health care costs, including long-term care) was between 55-58 percent. Not surprisingly, lower-income households have much lower RRRs: The 2013 baseline RRRs range from 16 percent for the households in the lowest-income quartile (meaning that 16 percent of the simulated lifepaths for that demographic are projected not to run short of funds in retirement) to 86 percent for the households in the highest income quartile.

In 2010, EBRI calculated the accumulated retirement adequacy deficits by age, family status, and gender for Baby Boomers, those born between 1948 and 1964, and Gen Xers, those born between 1965 and 1974. The aggregate deficit number, assuming current Social Security retirement benefits, is estimated to be \$4.6 trillion<sup>2</sup> with an individual average of approximately \$48,000. These numbers are present values at retirement age and represent the additional amount each member in that group would need at age 65 to eliminate their expected deficits in retirement (which could be a relatively short period or could last decades). Social Security benefits are, of course, an integral component of this equation. If Social Security benefits were to be eliminated, the aggregate deficit would jump to \$8.5 trillion and the average would increase to approximately \$89,000.

The 2010 analysis noted above incorporated the impact of the crisis in financial and housing markets in the 2007 through 2009 period. Even with these financial shocks to retirement savings, we found that, overall, the Baby Boomers and Gen Xers were significantly better off in 2010 than when we first ran the national model in 2003. The primary reason for this change was the adoption of automatic enrollment by a growing number of 401(k) plans (often accompanied by the adoption of automatic escalation of contributions) described later in this statement.<sup>3</sup>

An EBRI analysis in 2011 showed the tremendous importance of defined benefit pension plans in achieving retirement income adequacy for Baby Boomers and Gen Xers that have access to such programs. Overall, the presence of a defined benefit accrual at age 65 increases the probability of not running short of money in retirement by 11.6 percentage points. The defined benefit plan advantage is particularly valuable for the lowest-income quartile but also has a strong impact on the middle class.<sup>4</sup>

## The Potential of 401(k) Plans to Produce Adequate Income Replacement

The annual EBRI/ICI 401(k) database has been used to provide annual reports based on actual account balances of large cross-sections of 401(k) plan participants since 1996.<sup>5</sup> Looking at consistent participants in the EBRI/ICI 401(k) database in the wake of the financial crisis (over the four-year period from year-end 2007 to year-end 2011) a joint EBRI/ICI analysis found that the average 401(k) account balance fell 34.8 percent in 2008, then rose from 2009 to 2011.<sup>6</sup> Overall, the average account balance in this consistent sample increased at a compound annual average growth rate of 5.4 percent over the 2007–2011 period.

While this information is certainly useful to evaluate assertions (and anecdotal claims) with respect to the impact of the financial crisis on 401(k) plans, it needs to be supplemented with simulation modeling for a proper evaluation of the potential of 401(k) plans to produce “adequate” income replacement for several reasons:

- The EBRI/ICI 401(k) database does not contain information on IRA rollovers and therefore may only provide information on a fraction of a participant’s retirement accumulations if they have had job changes.
- Even if one looks only at 401(k) participants who have had decades of tenure with the current employer, there is a significant likelihood that they would not have been eligible to participate in a 401(k) plan during their entire career with the current employer.<sup>7</sup>
- Since the passage of the Pension Protection Act of 2006, many of the 401(k) plans that had previously allowed eligible employees to voluntarily enroll have been modified to automatically enroll eligible employees. While employees have the ability to opt out of such enrollment, it is clear that these plans have had a substantial impact on participation rates, especially for lower income employees.<sup>8</sup>



- An analysis based solely on current balances will not incorporate the impact of future employee activity (such as potential cash-out behavior at job change) nor the impact of future financial market returns.

To assist the Subcommittee in its evaluation of the role of 401(k) plans in the face of the retirement crisis, EBRI has used its RSPM to analyze the potential of 401(k) plans to produce “adequate” income replacement.<sup>9</sup> The analysis provides probabilities of successful retirement (defined below) by income quartile for both voluntary and automatic enrollment 401(k) plans. Given that the objective of this analysis is to focus on the potential for 401(k) plans to produce a threshold level of income replacement at retirement, the analysis is limited to those individuals who are simulated to have more than 30 years of eligibility for participating (whether or not they actually choose to participate in each of those years) by the time they reach age 65.<sup>10</sup>

Figure 1 summarizes the projections for the percentage of “successful retirements” for 401(k) participants by income quartile for those currently ages 25-29 in a voluntary enrollment 401(k) plan. Workers are assumed to retire at age 65 and all balances are converted into an inflation-adjusted annuity at an annuity purchase price of 18.62.<sup>11</sup> The annual income provided by these annuities in the first year of retirement is added to the simulated Social Security retirement benefit provided for the worker (spousal benefits are not included) and the combined retirement income is expressed as a percentage of the salary the worker was simulated to have earned at age 64.

One difficulty in evaluating the potential of any type of retirement income source is the determination of the threshold for “success”. While there have been a number of attempts to quantify this in the past;<sup>12</sup> there appears to be little consensus on the appropriate level(s).<sup>13</sup> Therefore the analysis in this article uses three alternative “success” thresholds: attaining 60, 70 and 80 percent, respectively, of the pre-retirement income replaced by the combination of the annuitized value of the 401(k) accumulations<sup>14</sup> combined with the primary Social Security benefit amounts.

The top row in the grid for Figure 1 shows that for the lowest income quartile<sup>15</sup> 86 percent of the workers currently ages 25-29 who will have more than 30 years of eligibility for participation in a 401(k) plan are simulated to be able to replace at least 60 percent of their age 64 salary from their annuitized 401(k) accumulations and Social Security. This percentage decreases somewhat for their higher income counterparts, but goes no lower than 83 percent.

The second row in the grid for Figure 1 provides the same results when the threshold is increased to 70 percent. As expected, the percentage of workers able to meet a more stringent threshold decreases and the percentage of those in the lowest income quartile with successful retirements under this analysis is now 76 percent. The percentages for the second, third and fourth income quartiles are somewhat smaller but none are less than 73 percent.

The third row in the Figure 1 grid illustrates the impact of increasing the threshold for success to 80 percent. At this point the progressive nature of the benefit formula in Social Security causes the lowest income quartile to have a much higher probability of success (67 percent) than the highest income quartile (59 percent).

Figure 2 presents a similar type of analysis as Figure 1, but in this case the automatic enrollment type of 401(k) plan is simulated rather than the voluntary enrollment type, where employees must make a positive election to participate in the plan. In addition, the simulated analysis for Figure 2 assumes that 401(k) sponsors adopting automatic enrollment provisions also adopt automatic escalation of contributions. Note that while automatic enrollment plans have been in place for a number of years, there has been a substantial increase in the proportion incorporating some type of an automatic escalation feature as a result of the Pension Protection Act of 2006. However, it will be a number of years before these provisions have been in place long enough to accurately assess participant response with respect to items such as opt-out behavior and whether participants will retain their current savings rates when they change jobs, or simply revert to the deferral rate in the plan of the new employer. In the current analysis, plans are assumed to have automatic escalation with a 1 percent of annual compensation increase along with the current plan-specific default contribution rates.<sup>16</sup> Employees are assumed to retain their previous level of contributions when they participate in a new plan and to opt-out of automatic escalation in accordance with the probabilities outlined in VanDerhei (September 2007).

It would appear from even a cursory comparison of the results in Figures 1 and 2 that this type of automatic enrollment plan would result in additional contributions sufficient to produce higher probabilities of success than the voluntary enrollment 401(k) plans in all income quartiles. For example, the top grid of Figure 2 shows that 94 percent of the lowest income quartile of workers currently ages 25-29 who will have more than 30 years of eligibility for participation in a 401(k) plan are simulated to be able to replace at least 60 percent of their age 64 salary in retirement from the annuitized 401(k) accumulations and Social Security. Again, these numbers drop somewhat for their higher-income

counterparts (88 percent for the highest income quartile) but are still substantially higher than the probabilities when voluntary enrollment is assumed.

The second row in the grid for Figure 2 presents the results when the threshold is increased to 70 percent. As expected, the percentage of workers able to meet this more stringent threshold decreases; the percentage of those in the lowest income quartile with successful retirements under this analysis is now 90 percent. Again the success percentages for the second, third and fourth income quartiles are somewhat smaller, but none are less than 81 percent.

The third row in the Figure 1 grid shows the impact of raising the threshold for success to 80 percent. At this point the benefit formula in Social Security causes the lowest income quartile to have a much higher probability of success (85 percent) than the highest income quartile (73 percent).

### Impact of a Potential Reduction in Social Security Retirement Benefits

The analysis presented in both Figures 1 and 2 assumes that the computation of Social Security retirement benefits under current law would not be modified. However, the current Social Security Trustee's Report projects that the OASDI fund will be exhausted by 2033.<sup>17</sup> Left unaddressed, while this would not result in Social Security retirement benefits being eliminated, it would seem to require a reduction in benefits for at least some cohorts of retirees. For purposes of the analysis in Figures 3 and 4, it was assumed that a proportional (and permanent) 24 percent reduction would be provided to the Social Security retirement benefits for all simulated workers.

As expected, the simulated reduction in Social Security retirement benefits would have a much larger impact on the lower income quartile; the percentage of the lowest income quartile under voluntary enrollment 401(k) plans with an 80 percent threshold drops 17 percentage points, from 67 percent to 50 percent, while the highest income quartile – which receives less proportionate benefits from Social Security – only drops by nine percentage points, from 59 percent to 50 percent (cf Figures 1 and 3).

A similar, but less pronounced, impact is found for the automatic enrollment plans (cf Figures 2 and 4). In this case, the percentage of the lowest income quartile with successful retirements at an 80 percent threshold drops 9 percentage points (from 85 percent to 76 percent) with the potential reduction in Social Security retirement benefits, while the highest income quartile drops only by 7 percentage points from 73 percent to 67 percent.

### Summary

Since 2003 EBRI research has documented and quantified the role of Social Security, defined benefit and private retirement accounts on retirement income adequacy for Baby Boomers and Gen Xers in the United States. This statement summarizes that research, and presents new evidence on the importance of 401(k) plans for workers currently entering the workforce. Assuming current Social Security benefits are not reduced, between 83 and 86 percent of workers with more than 30 years of eligibility in a voluntary enrollment 401(k) plan are simulated to have sufficient 401(k) accumulations that, when combined with Social Security retirement benefits, will be able to replace at least 60 percent of their age 64 wages and salary on an inflation-adjusted basis. When the threshold for a financially successful retirement is increased to 70 percent replacement of age 64 income, 73 to 76 percent of these workers will still meet that threshold, relying only on 401(k) and Social Security combined. At an 80 percent replacement rate, 69 percent of the lowest income quartile will still meet the threshold; however the percentage of those in the highest income quartile deemed to be "successful" relying on just these two retirement components slips to 59 percent.

When the same analysis is conducted for automatic enrollment 401(k) plans (with an annual 1 percent automatic escalation provision and empirically derived opt outs), the probability of success increases substantially: 88 to 94 percent at a 60 percent threshold; 81 to 90 percent at a 70 percent replacement and 73 to 85 percent at an 80 percent threshold.

EBRI looks forward to assisting the Subcommittee as they continue their investigations into this extremely important public policy topic.

## Appendix A: Brief Chronology of the EBRI Retirement Security Projection Model®

- The Retirement Security Projection Model® (RSPM) grew out of a multi-year project to analyze the future economic well-being of the retired population at the state level. The Employee Benefit Research Institute (EBRI) and the Milbank Memorial Fund, working with the office of the governor of Oregon, set out in the late 1990s to see if this situation could be evaluated for the state. The resulting analysis (VanDerhei and Copeland, September 2001) focused primarily on simulated retirement wealth with a comparison to ad hoc thresholds for retirement expenditures.
- The April 2001 EBRI Issue Brief (VanDerhei and Copeland, April 2001) highlights the changes in private pension plan participation for DB and DC plans and uses the model to quantify how much the importance of individual account plans is expected to increase because of these changes.
- With the assistance of the Kansas Insurance Department, EBRI was able to create the EBRI Retirement Readiness Rating™ (RRR) based on a full stochastic decumulation model that took into account the household's longevity risk, post-retirement investment risk, and exposure to potentially catastrophic nursing-home and home-health-care risks. The first state-level RSPM results were presented to the Kansas' Long-Term Care Services Task Force on July 11, 2002 (VanDerhei and Copeland, July 2002), and the results of the Massachusetts study were presented on Dec. 1, 2002 (VanDerhei and Copeland, December 2002).
- RSPM was expanded to a national model -- the first national, micro-simulation, retirement-income adequacy model, built in part from administrative 401(k) data. The initial results were presented at the EBRI December 2003 policy forum (VanDerhei and Copeland, 2003).
- The basic model was subsequently modified to quantify the beneficial impact of a mandatory contribution of 5 percent of compensation for testimony for the Senate Special Committee on Aging (VanDerhei, January 2004).
- The model was enhanced to allow an analysis of the impact of annuitizing defined contribution and IRA balances at retirement age (VanDerhei and Copeland, 2004).
- Additional refinements were introduced to evaluate the impact of purchasing long-term care insurance on retirement income adequacy (VanDerhei, 2005).
- The model was used to evaluate the impact of defined benefit freezes on participants by simulating the minimum employer-contribution rate that would be needed to financially indemnify the employees for the reduction in their expected retirement income under various rate-of-return assumptions (VanDerhei, March 2006).
- Later that year, an updated version of the model was developed to enhance the EBRI interactive Ballpark EStimate® by providing Monte Carlo simulations of the replacement rates needed for specific probabilities of retirement-income adequacy under alternative-risk-management treatments (VanDerhei, September 2006).
- RSPM was significantly enhanced for the May 2008 EBRI policy forum by allowing automatic enrollment of 401(k) participants with the potential for automatic escalation of contributions to be included (VanDerhei and Copeland, 2008).
- Additional modifications were added for a Pension Research Council presentation that involved a "winners/losers" analysis of defined benefit freezes and the enhanced employer contributions provided to defined contribution plans at the time the defined benefit plans were frozen (Copeland and VanDerhei, 2010).
- Also in 2009, a new subroutine was added to allow simulations of various styles of target-date funds for a comparison with participant-directed investments (VanDerhei, June 2009).
- In April 2010, the model was completely re-parameterized with 401(k)-plan design parameters for sponsors that had adopted automatic-enrollment provisions (VanDerhei, April 2010).
- A completely updated version of the national model was produced for the May 2010 EBRI policy forum and used in the July 2010 *Issue Brief* (VanDerhei and Copeland, 2010).
- The new model was used to analyze how eligibility for participation in a defined contribution plan impacts retirement income adequacy in September 2010 (VanDerhei, September 2010), and was later used to compute Retirement Savings Shortfalls (RSS) for Baby Boomers and Generation Xers in October 2010 (VanDerhei, October 2010a).
- In October testimony before the Senate Health, Education, Labor and Pensions Committee on "The Wobbly Stool: Retirement (In)security in America," the model was used to analyze the relative importance of employer-provided retirement benefits and Social Security (VanDerhei, October 2010b).
- The November Issue Brief expands upon earlier work by EBRI to provide the first results of a new simulation model that estimates the impact of changing 401(k) plan design variables and assumptions on retirement income adequacy. Until recently however, there was extremely limited evidence on the impact of automatic contribution escalation (VanDerhei and Lucas, 2010).
- In February the model was used to analyze the impact of the 2008–2009 crisis in the financial and real estate markets on retirement income adequacy (VanDerhei, February 2011).
- An April 2011 article introduced a new method of analyzing the results from RSPM (VanDerhei, April 2011). Rather than simply computing an overall percentage of the simulated life paths in a particular cohort that would not have sufficient

retirement income to pay for the simulated expenses, the new method computed the percentage of households that would meet that requirement more than a specified percentage of times in the simulation.

- As explored in the June 2011 *EBRI Issue Brief*, the RSPM allowed retirement-income adequacy to be assessed at retirement ages later than 65 (VanDerhei and Copeland, June 2011).
- In a July 2011 *EBRI Notes* article (VanDerhei, July 2011), RSPM was used to provide preliminary evidence of the impact of the "20/20 caps" on projected retirement accumulations proposed by the National Commission on Fiscal Responsibility and Reform.
- The August 2011 *EBRI Notes* article (VanDerhei, August 2011) used RSPM to analyze the impact of defined benefit plans in achieving retirement income adequacy for Baby Boomers and Gen Xers.
- In September, it was used to support testimony before the Senate Finance Committee (VanDerhei, September 2011) in analyzing the potential impact of various types of tax-reform options on retirement income. This was expanded in the November 2011 *EBRI Issue Brief* (VanDerhei, November 2011).
- A March 2012 *EBRI Notes* article (VanDerhei, March 2012) used new survey results to update the analysis of the potential impact of various types of tax-reform options on retirement income.
- The May 2012 *EBRI Notes* article (VanDerhei, May 2012) provided 2012 updates for the previously published RRRs as well as the RSS.
- The June 2012 *EBRI Notes* article (VanDerhei, June 2012) introduced severity categories in the RSS projections for Gen Xers.
- The August 2012 *EBRI Notes* article (VanDerhei, August 2012) provided additional evidence on whether deferring retirement to age 70 would provide retirement income adequacy for the vast majority of Baby Boomers and Gen Xers.
- The September 2012 *EBRI Notes* article (VanDerhei, September 2012) analyzed the impact of increasing the default-contribution rate for automatic enrollment 401(k) plans with automatic escalation of contributions.
- The November 2012 *EBRI Notes* article (VanDerhei, November 2012) reclassified the RRRs to provide additional information on those substantially above the threshold; close to the threshold; and substantially below the threshold.
- The March 2013 *EBRI Notes* article (VanDerhei and Adams, March 2013) used a modified version of RSPM to assess the probability that respondent households would not run short of money in retirement if they did, in fact, accumulate the amount they said would be required in the 2013 Retirement Confidence Survey.
- The June 2013 *EBRI Issue Brief* (VanDerhei, June 2013a) used RSPM to provide a direct comparison of the likely benefits under specific types of defined contribution (DC) and defined benefit (DB) retirement plans.
- The June 2013 *EBRI Notes* article (VanDerhei, June 2013b) used RSPM to show that 25–27 percent of Baby Boomers and Gen Xers who would have had adequate retirement income under return assumptions based on historical averages are simulated to end up running short of money in retirement if today's historically low interest rates are assumed to be a permanent condition.
- The August 2013 *EBRI Issue Brief* (VanDerhei, August 2013) used RSPM to analyze the Obama administration's FY 2014 budget proposal to include a cap on tax-deferred retirement savings that would limit the amounts accumulated in specified retirement accounts to that necessary to provide the maximum annuity permitted for a tax-qualified defined benefit plan under current law.
- The December 2013 *EBRI Notes* article (VanDerhei, December 2013) used RSPM to expand the analysis in the June 2013 *Issue Brief*. Rather than trying to reflect the real-world variation in DB accruals, the baseline analysis in the previous analysis used the median accrual rate in the sample (1.5 percent of final compensation per year of participation) as the stylized value for the baseline counterfactual simulations. The new research computes the actual final-average DB accrual that would be required to provide an equal amount of retirement income at age 65 as would be produced by the annuitized value of the projected sum of the 401(k) and IRA rollover balances.

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## Endnotes

<sup>1</sup> See Appendix A for a brief chronology of the model.

<sup>2</sup> This number is somewhat larger than the \$4.3 trillion reported in VanDerhei (May 2012); however, the baseline assumptions used in the 2010 analysis did not provide for the utilization of net housing equity to ensure retirement income adequacy. When the analysis is repeated with the same assumptions as used in 2010, the aggregate deficit actually increases to \$4.8 trillion.

<sup>3</sup> As a result of several requests to determine the impact of the financial and real estate market crises on overall retirement income adequacy, EBRI conducted another analysis in 2011 that found the percentage of households that would not have been “at risk” without the 2008–2009 crisis but that ended up “at risk” varies from a low of 3.8 percent to a high of 14.3 percent. See VanDerhei (February 2011) for more detail.

<sup>4</sup> See VanDerhei (August 2011) for more detail. It should be noted that the huge impact on retirement income adequacy of having a defined benefit plan accrual at age 65 may be a bit misleading given that any participant changing jobs prior to age 65 is assumed to receive a lump sum distribution instead of a terminated vested annuity if the present value of the accrual falls below statutory thresholds. Although the “defined benefit vs. defined contribution” debate has produced a substantial amount of conjecture in recent years, a careful analysis of the ability to generate “adequate” retirement income under either type of retirement plan needs to include proper data and methods to simulate future job changes and employee behavior at that time as well as future participation, contribution and asset allocation decisions by defined contribution participants. See VanDerhei (June 2013a) and VanDerhei (December 2013) for an example of this type of comparative analysis.

<sup>5</sup> See VanDerhei, Holden, Alonso and Bass (December 2013) for the most recent results.

<sup>6</sup> VanDerhei, Holden, Alonso and Bass (October 2013).

<sup>7</sup> The proposed regulations for 401(k) plans were first introduced in November of 1981 and it took several years for many sponsors to introduce the plans. Moreover, many plans that were originally introduced as supplemental plans to existing defined benefit plans have been modified to provide more generous employer contributions at the time the defined benefit plans were frozen (VanDerhei, April 2010).

<sup>8</sup> See Figure 23 of Utkus and Young (2013) for recent evidence.

<sup>9</sup> Additional details on RSPM and the assumptions used in 2013 can be found in VanDerhei (June 2013b). The financial market results are generated from stochastic annual returns with a log-normal distribution and an arithmetic mean of 8.6-percent real return for stocks and 2.6 percent real return for bonds.

<sup>10</sup> For an indication of how years of eligibility impact overall Retirement Readiness Ratings, see VanDerhei (June 2013b). This analysis simulates the impact of future years of eligibility for a defined contribution plan on the probability of households NOT running short of money in retirement. As can be seen in Figure 3 of that analysis, the probability that a Gen Xer household with no future years of defined contribution eligibility will not run short of money in retirement is 38.6 percent. This increases to 59.8 percent for Gen Xer households with 1-9 years of future eligibility and 73.4 percent for those with 10-19 years. More than 17 out of 20 (86.1 percent) of Gen Xer households with more than 20 years of future eligibility are simulated to not run short of money in retirement. This analysis was for all income quartiles combined. Similar results are found when we control for relative levels of pre-retirement income (see Figure 4 of VanDerhei May 2012).

<sup>11</sup> The annuitization of the balances are performed only for purposes of providing an income stream that can be added to the inflation-adjusted annuity provided by Social Security. Indeed, only a small percentage of defined contribution participants currently annuitize their entire account balance at retirement (and even a smaller percentage purchase an inflation-adjusted annuity for the entire amount). When RSPM is used to compute Retirement Readiness Ratings (the probability that a particular cohort will not run short of money in retirement), the defined contribution and IRA balances are not assumed to be annuitized but instead are assumed to be spent down as needed.

<sup>12</sup> See MacDonald and Moore (2011) for a very thorough review of the literature.

<sup>13</sup> One reason for this is the need to determine how potentially catastrophic health care costs (such as nursing home costs) in retirement will be handled. Even though these costs will not be an issue for all retirees, and certainly not a problem in every year of retirement, a multi-year stay in a nursing home in retirement may deplete the retirement savings of a household to the point where it eventually runs short of money in retirement. See VanDerhei (August 2012) for more detail.

<sup>14</sup> The phrase “401(k) accumulations” in this analysis denotes both accumulations in 401(k) accounts at retirement age as well as IRA rollovers that originated from 401(k) plan accumulations.

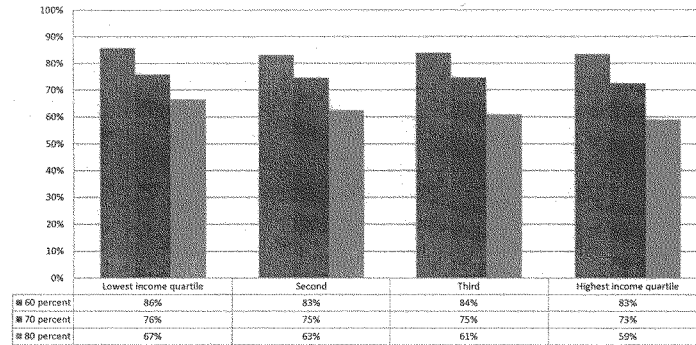
<sup>15</sup> RSPM needs to use information during the worker’s entire career to determine pre-retirement income quartiles (similar to the AIME calculation for Social Security). This is explained in endnote 17 of VanDerhei and Copeland (2010).

<sup>16</sup> VanDerhei (September 2012) simulated the impact of increasing the current plan-specific default rates (typically 3 percent of compensation) to 6 percent. Under a set of specified behavioral assumptions, more than a quarter of those in the lowest-income quartile who had previously NOT been successful under actual default contribution rates were found to be successful as a result of the change in deferral percentage.

<sup>17</sup> The 2013 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds

**Figure 1**

Percentage of successful\* retirements for voluntary enrollment 401(k) plans by income quartile:  
Current Social Security retirement benefits

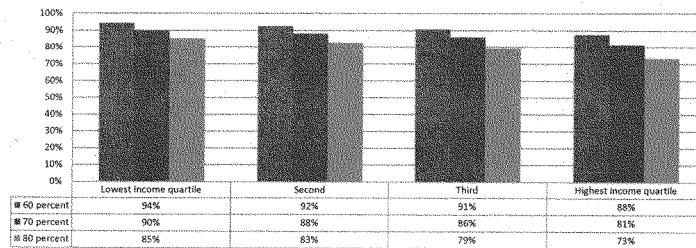


Source: EBRI Retirement Security Projection Model, versions 1950 and 1951.

\* "Success" is defined as achieving an X percent real replacement rate from Social Security and 401(k) accumulations combined as defined in VanDerhei and Lucas (2010) where X = 60, 70 or 80. The population simulated consists of workers currently ages 25–29 who will have more than 30 years of simulated eligibility for participation in a 401(k) plan. Workers are assumed to retire at age 65 and all 401(k) balances are converted into a real annuity at an annuity purchase price of 18.62.

**Figure 2**

Percentage of successful\* retirements for automatic enrollment 401(k) plans with automatic escalation\*\* by income quartile:  
Current Social Security retirement benefits



Source: EBRI Retirement Security Projection Model, version 1976.

\* "Success" is defined as achieving an X percent real replacement rate from Social Security and 401(k) accumulations combined as defined in VanDerhei and Lucas (2010) where X = 60, 70 or 80. The population simulated consists of workers currently ages 25–29 who will have more than 30 years of simulated eligibility for participation in a 401(k) plan. Workers are assumed to retire at age 65 and all 401(k) balances are converted into a real annuity at an annuity purchase price of 18.62.

\*\*Plans are assumed to have automatic escalation with a 1 percent of annual compensation increase and plan-specific default contribution rates. Employees are assumed to retain their previous level of contributions when they participate in a new plan and opt out of automatic escalation in accordance with the probabilities in VanDerhei (September 2007).





### Statement for the Record

**Senate Finance Subcommittee on Social Security, Pensions, and Family Policy Hearing**  
***The Role of Social Security, Defined Benefits, and Private Retirement Accounts in the***  
***Face of the Retirement Crisis***

December 23, 2013

United States Senate Committee on Finance  
 Subcommittee on Social Security, Pensions, and Family Policy  
 215 Dirksen Senate Office Building  
 Washington, DC 20515

Chairman Brown and Ranking Member Toomey:

On behalf of the Employee-Owned S Corporations of America (ESCA), we would like to take this opportunity to submit a statement for the record to your Subcommittee's December 18, 2013 hearing, *The Role of Social Security, Defined Benefits, and Private Retirement Accounts in the Face of the Retirement Crisis*.

Since they were established by Congress 15 years ago, S corporation ESOPs have accomplished exactly what Congress intended them to do: promote retirement savings through employee ownership. Indeed, the data suggest that the so-called "S-ESOP" structure is perhaps the most effective retirement savings tool contained in current statute, generating billions in savings for average American workers that they otherwise would never have the opportunity to amass. As your Subcommittee explores solutions to address the lack of adequate retirement savings for American workers more broadly, and as the Finance Committee continues to pursue comprehensive tax reform, we urge you to keep this success story in mind. Indeed, as Senator Toomey noted recently, U.S. retirement policy should "recognize the strengths of the current retirement system and preserve what works." This is what compels us to share with you the background below on S ESOP and to provide recommendations on how to extend the benefits of the S ESOP structure to other companies and workers in the nation.

#### What is an S Corporation ESOP?

A Subchapter S corporation is a business entity that provides flow-through tax treatment to its shareholders. An employee stock ownership plan ("ESOP") is a qualified defined contribution plan that provides a company's workers with retirement savings through their investments in their employer's stock, **at no cost to the worker**. ESOPs are regulated by the Employee Retirement Income Security Act ("ERISA") just like pension funds, 401(k) plans, and other qualified retirement plans. Congress authorized the S corporation ESOP structure to encourage and expand retirement savings by giving hundreds of thousands of American workers in all 50 states the opportunity to have equity in the companies where they work.

### **S Corporation ESOPs Effectively Promote Retirement Savings**

***At a time when almost 50% of working Americans have no employer-provided retirement savings plan, employee-owners have at least one plan wholly funded by their companies, and in most cases, a separate plan outside of the ESOP (such as a 401(k)).***

Not long ago, a University of Pennsylvania/Wharton School of Business study found that S corporation ESOPs contribute ***\$14 billion in new savings for their workers each year beyond the income they would otherwise have earned***, and that S corporation ESOPs offer workers greater job stability and increased job satisfaction. The study also found that S corporation ESOPs' higher productivity, profitability, job stability and job growth generate a collective ***\$19 billion in economic value that otherwise would not exist***.

The National Center for Employee Ownership ("NCEO") found that S corporation ESOPs are a major force in providing retirement security to workers. A 2005 NCEO survey reported that S corporation employee-owners had ESOP account balances ***three to five times higher than the U.S. average for 401(k) plan participants***. For S corporation employee-owners nearing retirement, ESOP account balances were ***five to seven times the average***. More than 80 percent of companies surveyed by NCEO offer their employees more than one qualified retirement plan.

### **Data Supports the Tremendous Value of S Corporation ESOPs on the American Economy**

In April, Alex Brill, tax advisor to the Simpson-Bowles deficit reduction commission, released a new study looking at the "Macroeconomic Impact of S ESOPs on the U.S. Economy." In addition to promoting retirement savings, Brill found that S ESOPs also have a positive impact on the nation's economy as a whole. Key findings from this report reveal that:

- **The number of S ESOPs and the level of active participation (number of employee-owners) have more than doubled since 2002.**
- **Total output from S ESOPs and the industries they support is nearly 2 percent of GDP.**
- S ESOPs directly employ 470,000 workers and support nearly a million jobs in all.
- S ESOPs paid \$29 billion in labor income to their employees, with \$48 billion in additional income for supported jobs.

The new study followed a 2012 study by Brill that found:

- Employment among surveyed S ESOP firms increased more than 60% from 2001-2011, while the private sector as a whole had flat or negative growth in the same period.
- In the struggling manufacturing industry in particular, the S ESOP structure has buffered against economic adversity and job loss.
- S ESOPs have significantly expanded the pool of US workers who are saving for retirement, while also boosting company productivity – something that has greatly benefited their employee-owners.

Additionally, in a 2010 Georgetown University/McDonough School of Business study, two leading tax economists reviewed the performance of a cross-section of S corporation ESOP companies during the recent recession and found that these companies performed better than other companies in job creation, revenue growth, and providing for workers' retirement security.

Specifically, the Georgetown study found that:

- **Companies that are S corporation ESOPs are proven job-creators, even during tough times.** While overall U.S. private employment in 2008 fell by 2.8%, employment in surveyed S corporation ESOP companies rose by 2%. Meanwhile, 2008 wages per worker in surveyed S corporation ESOP companies rose by 6%, while overall U.S. earnings per worker grew only half that much.
- **S corporation ESOP companies provided substantial and diversified retirement savings for their employee-owners at a time when most comparable companies did not.** Despite the difficult economic climate, surveyed S corporation ESOP companies increased contributions to retirement benefits for employees by 19%, while other U.S. companies increased their contributions to employee retirement accounts by less than 3%.

**Support for S Corporation ESOPs is Bipartisan**

In April, your colleagues on the Senate Finance Committee, Senators Ben Cardin and Pat Roberts, reintroduced bipartisan legislation, S. 742, the *Promotion and Expansion of Private Employee Ownership Act of 2013*, that will:

- ***Encourage owners of S corporations to sell their stock to an ESOP***
- ***Provide additional technical assistance for companies that may be interested in forming an S corporation ESOP***
- ***Protect small businesses that become ESOPs from losing their SBA certification***
- ***Acknowledge the importance of preserving the S corporation ESOP structure in the Internal Revenue Code***

Senator Brown is already one of the 5 other Finance Committee members (in addition to the original sponsors, they include Senators Stabenow, Thune and Crapo) who have cosponsored this measure. All told, there are 18 Senators -- 10 Democrats, 1 Independent and 7 Republicans -- currently supporting this bill. Beyond legislative cosponsorships, we know there is widespread bipartisan Congressional support for employee-ownership and the S ESOP.

ESCA appreciates your Subcommittee's focus on retirement security and identifying solutions to address the issue. ESCA welcomes the opportunity to continue to work with you, other Subcommittee members, and your staff on this matter and we hope that you will use us as a resource.

Sincerely,



Stephanie Silverman  
President & Executive Director

*The Employee-Owned S Corporations of America ("ESCA") is the Washington, DC voice for employee-owned S corporations. ESCA's exclusive mission is to advance and protect S corporation ESOPs and the benefits they provide to the employees who own them. These companies have an important story to tell policymakers about the tremendous success of the S ESOP structure in generating long-term retirement savings for working Americans and their families. ESCA provides the vehicle and the voice for these efforts. ESCA represents employee-owners in every state in the nation.*

**Written Statement of J. Michael Keeling, President of The ESOP Association, to the Senate Committee on Finance, Subcommittee on Social Security, Pensions, and Family Policy**

**December 18, 2013, The Role of Social Security, Defined Benefits, and Private Retirement Accounts in the Face of the Retirement Crisis**

*Comments drafted by:*

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Thank you, my comments focus on employee ownership through the ESOP (employee stock ownership plan) model.

ESOPs are often referred to as ERISA plans. The record should show that an ESOP is a tax qualified deferred compensation plan that by law is required to be primarily invested in employer securities and may use borrowed funds to acquire the assets of the plan.

Employee stock ownership is by no means a new phenomenon in the United States. The roots of the employee ownership cause can be traced to the founders of this country and several notable historical U.S. figures including Presidents George Washington, John Adams, Thomas Jefferson, and Abraham Lincoln. For instance, a new book called *The Citizen's Share: Putting Ownership Back into Democracy* (co-authored by preeminent employee ownership researchers Joseph R. Blasi, Richard B. Freeman, and Douglas L. Kruse) discusses the history of the employee ownership movement and its value to the American people. On page 181 of *The Citizen's Share*, the question is asked: "Do workers gain from a property stake in their firm?" While the authors point out that the answer may seem obvious, they do go on to note that there is strong evidence to support the statement that employee stock ownership does have a meaningful impact on the lives of workers and their wealth. For instance, studies have shown that, "Workers with profit sharing or employee stock ownership are higher paid and have more benefits than other workers." (pg. 181) The authors go on to state, "These workers also obtain more training and have greater job security than other workers, and enjoy better work conditions with greater participation in decisions, better treatment by the employer, and less supervision." (pg. 182)

As has been said, by the Association and by others, while employee stock ownership is not a cure all, it is good for American workers, it is good for American businesses, and it is good for American communities. Congress has consistently endorsed employee ownership through the ESOP model. There is a long history of supporting laws that encourage the creation and operation of ESOPs because in the vast majority of instances, ESOP companies are more productive, more profitable, with sustainable jobs for their employees that are locally controlled, while providing retirement benefits that are greater than most U.S. conventionally-owned companies. Now is not the time to change that for the American people.



## Employee Ownership & Corporate Performance

- Employees in the U.S. who worked in companies with employee stock ownership were four times less likely to be laid off during the Great Recession than employees without employee stock ownership. 3% of employees with employee stock ownership, which include the ESOP model and other forms of employee ownership, were laid off in 2009-2010 compared to a 12% rate for employees without employee stock ownership. *(Information from the 2010 General Social Survey conducted by the National Opinion Research Center at the University of Chicago and analyzed by Rutgers University professors, Dr. Joseph Blasi and Dr. Douglas Kruse, well-known researchers of employee ownership.)*
- 11 million American worked in companies with employee stock ownership plans, or ESOPs, in 2010. Savings from the low layoff rate of ESOP participants was \$13.7 billion in 2010, or almost 14 times more than the estimated \$1 billion a year tax expenditure attributed to the special laws promoting ESOP creation and operation. *(The Impact of Employee Ownership and ESOPs on Layoffs and the Costs of Unemployment to the Federal Government, by Corey Rosen, Senior Staff Member and Founder, the National Center for Employee Ownership, released February 5, 2013 and funded by the Employee Ownership Foundation, the affiliated 501(c) 3 foundation of The ESOP Association.)*
- The most recent survey conducted among The ESOP Association's 1,500 corporate members showed an increase in age of the ESOP and account balances. In 2010, the average age of the ESOP was reported to be 15 years, demonstrating ESOP companies are sustainable. The average account balance rose dramatically to \$195,222.65. And approximately 90% of members reported having retirement savings plans in addition to the ESOP including the use of 401(k) plans, pension plans, stock purchase plans, and stock options. In terms of motivation and productivity, 84% of respondents agree that the ESOP improved motivation and productivity. *(The ESOP Company Survey is conducted every five years by The ESOP Association and Employee Ownership Foundation among the members of The ESOP Association. The ESOP Company Survey was also completed in 2005 and 2000.)*
- A study, which reviewed data from the Department of Labor Form 5500s on defined contribution retirement plans, found: ESOP companies have at least one plan, the ESOP, but more than half (56%) have a second retirement savings/defined contribution plan, likely a 401(k) plan. In comparison, the Bureau of Labor statistics reports that less than half of companies have any kind of retirement savings plan which shows that an ESOP company is more than likely to have two retirement savings plans in comparison to over half of non-ESOP companies which have no plan at all. *(This research project was conducted by the National Center for Employee Ownership (NCEO) and funded by the Employee Ownership Foundation, the affiliated 501(c) 3 foundation of The ESOP Association.)*



National Conference on  
**Public Employee Retirement Systems** *The Voice for Public Pensions*

**NCPERS Written Statement for the Hearing Record  
 Regarding The Role of Social Security,  
 Defined Benefits and Private Retirement Accounts  
 in the Face of the Retirement Crisis**

by Hank Kim, Esq.

Executive Director and Counsel

National Conference on Public Employee Retirement Systems (NCPERS)

Submitted to the United States Senate Committee on Finance

Subcommittee on Social Security, Pensions and Family Policy

December 18, 2013

Introduction

Chairman Brown, Ranking Member Toomey and members of the subcommittee, thank you for allowing my organization, the National Conference on Public Employee Retirement Systems (NCPERS), to submit this on the record testimony for your review. There is no question that America is facing a retirement crisis of unprecedented proportions, with profound implications not only for the financial security of millions of Americans in retirement, but for the nation's economic health and well being. We applaud this subcommittee for giving the retirement crisis a prominent place in our national debate. The solutions policymakers devise for addressing this crisis will determine the quality of life for our retired citizens and the economic strength of our nation far into the future.

NCPERS is the largest trade association for public sector pension funds, representing more than 550 funds throughout the United States and Canada. It is a unique non-profit network of public trustees, administrators, public officials, and investment, actuarial and legal professionals who collectively manage more than \$3 trillion in pension assets. Founded in 1941, NCPERS is the oldest trade association working to promote and protect pensions by focusing on advocacy, research and education for the benefit of public sector pension stakeholders. Further, NCPERS promotes retirement security for *all* workers -- in both the public and private sectors -- through access to defined benefit pension plans.

In addition to serving as Executive Director and Counsel for NCPERS, I currently serve as Vice-Chair of the Fairfax County Uniform Retirement System, \$1.3 billion public employee retirement system providing pension coverage for the Fire & Rescue Department, Sheriff's Department, and certain other sworn employees of Fairfax, Virginia. I also serve as Treasurer of the National Institute on Retirement Security, a Washington, D.C. based think tank focusing on retirement security. Previously, I've served on the Morningstar Pension Endowments and

Foundations Steering Committee and the City of Virginia Beach Mayor's Committee on Employee Pensions.

#### America's Retirement Crisis

The U.S. retirement crisis primarily affects workers in the private sector – although continuing attacks on public sector pensions could easily compound our current retirement dilemma. Public pension plans are typically defined benefit plans that guarantee participants a predictable income for life. NCPERS, in partnership with Cobalt Community Research, a nonprofit research coalition created to help governments, schools and other nonprofit organizations measure, benchmark and manage their efforts, surveys public pension plans every year. Our surveys consistently show that – with a few exceptions in jurisdictions whose legislatures failed to fund their plans adequately or at all during boom economic times – public pension plans are adequately funded, financially healthy and sustainable for the long term. Like all institutional investors, public pension plans took a substantial hit during the Great Recession. But our surveys, based on the most up-to-date information available, show that public pension plans have made a strong recovery and are experiencing strong returns on their long-term investments.

Our 2013 survey shows that public employee defined benefit pension plans remain the most cost-effective instruments for providing retirement income. The overall average expense to administer public pension plans and pay investment manager fees this year was just 57.3 basis points – compared to an average of 77 basis points for equity and hybrid mutual funds. And the majority of plans have undertaken systemic and operation reforms – such as implementing additional cost savings and wringing out as much internal efficiencies as possible, increasing contributions, and making other difficult reforms – to ensure their sustainability for the long term.

As a result of these reforms and the bull market the nation has enjoyed since 2009, public pensions have more assets under management now than they had prior to the Great Recession. According to the Federal Reserve, at the end of the 3rd Quarter of this year, public pensions collectively held in trust more than \$3.7 trillion for the benefit of state and local employees like teachers, public safety officers, and other public employees. Our survey shows the average funding level at a sustainable level of over 70 percent (Fitch Ratings considers funding level of 70 percent to be adequate). Public pensions on average cost less than six percent of state budgets and virtually all public pensions are contributory plans, meaning that the employees who participate in the plans help pay for their own benefits. Contrary to common misconceptions, the average public pension benefit is around \$25,000 per year. While the benefits are modest, it does represent enough income replacement so that petitioners can maintain their standard of living in their retirement years and not become wards of the state.

The private sector, on the other hand, is facing a retirement savings deficit somewhere upwards of \$14 trillion. This retirement saving deficit is calculated by determining what 401(k) account holders should have in their accounts to maintain their standard of living in their retirement and comparing that with what they actually do have in their accounts. Recently, the Wall Street Journal ran on its front page a story about the retirement savings crisis. Entitled “Workers Saving Too Little to Retire,” the article noted that fifty-seven percent of U.S. workers surveyed reported

less than \$25,000 in total household savings for retirement. This is extremely troubling because as documented in our publication *The Secure Choice Pension: A Way Forward for Retirement Security in the Private Sector*, Social Security gets a typical retiree about one-third of the way towards a secure retirement. The remaining two-thirds must be made up from personal savings solely or in conjunction with an employer sponsored pension plan.

Most acutely, the 78 million baby-boomers who are now at or nearing retirement may not have enough time left in the workforce to earn back what they have lost in retirement assets during the Great Recession. Our ability as a nation to sustain our economy at a time when a record number of workers are entering their retirement years should be an important part of our national debate. Retirement security for *all* Americans – whether they work in the public or private sector – must become a national priority. If we do not address this issue effectively now, we will be faced with millions of retirees with insufficient retirement assets who will not be active participants in the economy and who will be reliant to some extent on public services. The potential negative impact of that on economic growth, tax revenue generation and Americans' standard of living is profound.

#### A New Approach

The growing retirement security dilemma has forced many thought leaders and policymakers to take a fresh look at this growing crisis. Because Social Security cannot provide enough and personal retirement savings are not great enough, more and more attention is being focused on restoring the traditional third leg of the proverbial retirement security stool to the private sector – the defined benefit pension.

At NCPERS, this examination began in late 2010. We knew that not only was there a need for revitalization of pensions in the private sector, but there was a keen desire by working Americans for the type of retirement security that public sector employees have earned and enjoy. So for a year we embarked upon a journey to study what the next evolution of pensions for the private sector might be. We dubbed this exercise “Pensions 2.0.” We asked ourselves what a private sector pension would look like if it reflected the realities of the 21<sup>st</sup> Century. Namely, the pension plan had to be flexible to reflect economic conditions, portable so that participants can carry it from job to job, simple to administer, and most importantly sustainable for not just the next 20 years but for the next 200 years.

Our answer is the Secure Choice Pension (SCP). The SCP is envisioned as a public-private partnership to provide retirement security for American workers, particularly those who work for small businesses, and who don't currently have a defined benefit pension. The plan draws on the documented performance and efficiencies of public sector pension management, and extends it to employers and employees in the private sector. The concept is that the states – individually, or possibly in groups – would enact legislation to establish a state or regional SCP plan. SCPs would be multiple-employer hybrid defined benefit pension plans. Each SCP would have a board of trustees composed of state, private employer and private employee/retiree representatives. The board would hire a chief executive officer and administrative staff to administer the SCP. The board and staff would have fiduciary duty to the SCP plan and its participants.



Participation in the SCP would be voluntary. Contributions to the SCP would come ideally from both employers and employees. In our model plan the combined contribution is set at 6% of pay and would replace approximately one-third of average career salary at retirement. For participating employers, administrative and fiduciary duties would be largely removed and placed upon the board of trustees and administrator of the plan. The only real obligation and administrative task for employers would be to make their portion of the contribution – thus making participation in the SCP affordable and simple for private sector employers, in terms of both time and financial cost. While each SCP participant would have a participant account, all contributions to the SCP would be pooled and professionally invested to achieve economies of scale and to negotiate lower fees from investment firms hired by the SCP board.

The participant accounts would grow at an interest rate that the SCP board would set annually, but the SCP plan guarantees a minimum of three percent return. At retirement, employees participating in a SCP would be guaranteed an income for life – an income immune to stock market fluctuations and sudden economic downturns. And because a SCP would be funded entirely through employer/employee contributions, it would represent no cost and no risk to taxpayers.

Once we had the SCP plan design and actuarially determined funding approach, we developed rigorous modeling and stress tested the SCP concept to assess its performance. We believe that the SCP is the most detailed and most thoroughly tested public-private partnership pension concept available. It is in part for this reason that NCPERS has been asked to assist in developing and drafting state-based private sector retirement savings legislation.

It is worth noting that concerns about a lack of retirement security among their citizens – and the potential negative consequences on their economies and tax revenues – has prompted a number of states to explore public-private partnerships to provide retirement savings plans for private sector workers.

In March of 2012, the Massachusetts legislature passed, and the governor signed, a law titled “An Act to Provide Retirement Options for Nonprofit Organizations.” The new law – one of the first of its kind – will allow nonprofit organizations with fewer than 20 employees to enter into a contributory retirement plan overseen by the state treasurer’s office. Currently, the treasurer’s office oversees a contributory plan for public sector employees with \$5 billion in assets that covers approximately 300,000 workers. Adding the plan for nonprofit organizations will not have a significant impact on operations. The treasurer’s office will create a trust to receive qualified contributions from nonprofit employers and employees, and will establish a non-profit defined contribution committee that will include the treasurer and four other members.

Last September, California’s legislature passed, and its governor signed, a law to create a statewide retirement savings plan known as the California Secure Choice Retirement Savings Program (SCRSP). The plan is for private workers who do not participate in any other type of employer sponsored retirement savings plan. Contributions by employees will be voluntary. Before the SCRSP becomes operational, the SCRSP Board created by the law must conduct a

market analysis to determine various factors concerning implementing the SCRSP and report its findings to the Legislature. Once created, administrative costs for the SCRSP will be paid for from earnings on investments into the trust – not by California taxpayers. Those administrative costs are capped at no more than 1 percent, annually, of the total program fund assets.

In an effort to follow in the footsteps of Massachusetts and California, Oregon's legislature passed a bill in July to form a task force to explore options for helping private sector workers who do not have access to retirement savings plans at their workplace. Roughly half of Oregon's private workers have no access to such a plan, and access is lowest among lower-income minority workers. And only 40 percent of private sector workers participate in workplace retirement plans. Among other things, the seven-member Oregon Retirement Savings Task Force will develop recommendations for increasing the percentage of Oregonians enrolled in a retirement plan and for creating tax incentives and marketing strategies to encourage businesses to offer retirement savings plans to their employees. The legislation was backed by AARP, labor groups and small businesses.

#### Conclusion

NCPERS wishes to thank the subcommittee for this opportunity to express our views and offer our insights as you contemplate policies for addressing the private sector retirement crisis. NCPERS stands ready to assist this subcommittee and other policymakers with facts, research, and expertise as they delve into policy discussions on retirement security. We invite the subcommittee to contact us should you need additional information.

# # #



National Conference of  
State Social Security Administrators

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President Rita Foltman  
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Statement for the Record Submitted to the  
United States Senate Committee on Finance  
Subcommittee on Social Security, Pensions, and Family Policy  
Hearing Entitled, "The Role of Social Security, Defined Benefits, and  
Private Retirement Accounts in the Face of the Retirement Crisis"  
Hearing Held on December 18, 2013

December 20, 2013

Senate Committee on Finance  
Attn. Editorial and Document Section  
Rm. SD-219  
Dirksen Senate Office Bldg.  
Washington, DC 20510-6200

RE: Opposition to Universal (Mandatory) Social Security for State and Local Government Employees

Dear Committee Members:

The National Conference of State Social Security Administrators (NCSSSA) has been a recognized leader in the area of Social Security/Medicare coverage and other employment taxes for over sixty years. Since its inception in 1951, the NCSSSA has represented state and local governments' interest with respect to these federal programs. NCSSSA represents more than 89,500 state and local government employers nationwide.<sup>1</sup> We write to oppose any efforts to mandate Social Security (often cited as mandatory or universal Social Security) coverage for state and local government employees. ***We respectfully request the Congress and the President to resist the urge to address the nation's Social Security funding crises by extending the Social Security tax to currently exempt state and local government employees throughout the country.***

Our reasons for opposing universal Social Security for state and local government employees fall into four fundamental categories:

1. **Such Action is Unconstitutional.** The exception from Social Security coverage for state and local government employees was included in the original version of the

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<sup>1</sup> Source: U.S. Census Bureau, *The 2012 Statistical Abstract: The National Data Book*. Available at: <http://www.census.gov/compendia/statab/2012/tables/12s0429.pdf>.

Social Security Act (HR7260), passed in 1935. The committee reports on the act contain no discussion of the exception provision. In the January 22, 1935 hearings of the Committee of Ways and Means, however, Dr. E. E. Witte, Executive Director of the Committee on Economic Security, was quoted as saying:

"Government employees are excluded from the tax for obvious reasons. The federal government cannot impose a tax on the states or the political subdivisions of the states. This is a tax measure. . . ."

This original exception is the federal government's recognition of its constitutional limitation to mandate a social security employer tax on the states and their political subdivisions. According to the House Ways and Means Committee Print 97-34:

". . . [t]he Social Security Act of 1935 excluded from coverage all employment for states and localities, primarily because of the question of the constitutionality of any general levy of the employer tax on states and localities."

To overcome this constitutional limitation, Congress amended the Social Security Act (Act) in 1950 to add Section 218. This section allowed for voluntary coverage of state and local government employees, at the request and approval of the governmental employer. All Section 218 (voluntary coverage) Agreements must be coordinated and directed by a designee of the Governor of each state. Individual governmental employers cannot enter into a Section 218 Agreement with the federal government without the states' involvement. At the time Section 218 was adopted, Social Security contributions, in lieu of taxes, were made by both the governmental employer and employee once voluntary coverage was obtained.

Although further amendments to the Act have been made over the years, Congress has been somewhat faithful to this voluntary coverage concept. The Omnibus Budget Reconciliation Act of 1990 (OBRA '90) requires Social Security coverage for every state and local government employee who does not belong to a qualified, public retirement system or who is not covered by Social Security under a Section 218 Agreement. OBRA '90 avoided the constitutionality question by retaining the states' and their political subdivisions' right to determine if employees will be covered under Social Security or a public retirement plan.

NCSSSA believes that efforts to mandate Social Security for state and local government employers and employees is still unconstitutional as the federal government lacks constitutional authority to impose a general levy of the employer tax on state and local governments as employers. Further, because OBRA '90 required Social Security coverage for any employee not covered by a voluntary Section 218 Social Security Agreement or a public pension plan, basic protections are already ensured for all public sector employees, thereby precluding the need for Congress to mandate full Social Security coverage to protect government workers.

2. **Such Action Would Decimate State and Local Pension Systems and the Employers and Employees Who Make Contributions to Fund Them.** In

September 2011, the Coalition to Preserve Retirement Security<sup>2</sup> documented that universal coverage will cost states, localities and public workers \$53.5 billion in the first five years to buy only a short-term extension of Social Security solvency. The Coalition noted that it must be recognized that this short-term cash injection results in long-term liabilities to the Social Security system. Moreover, this mandate could disrupt the current funding and benefit structure of existing public employee retirement plans as employers and employees adjust to paying the Social Security contribution. Public employers continue to be challenged by the economic downturn and slow recovery. Requiring participation in Social Security would put additional demands on, or divert limited economic resources from, constituent services or funding of existing retirement arrangements. It should be noted that many of these plans were established either prior to Social Security or during the period after its establishment when states and localities were prohibited from participation.

Universal coverage will raise the cost of maintaining current benefit levels. Shifting contributions to Social Security and away from current programs could leave public plans with significant funding challenges. The assets contributed to a public plan to fund future benefits are invested. The investment returns earned on these assets help in a major way to cover the costs of future benefit obligations. Reduced contributions will result in lower investment earnings and will further compound funding concerns (during a 25-year period ending in 2009, over 60 percent of public plan assets were generated from investment returns). As contributions to the public plans decrease, the associated investment earnings will be lower, requiring governments to make up the difference in order to maintain current benefit levels.<sup>3</sup>

Despite some reports to the contrary, the vast majority of public pension plans are financially sound and well managed.<sup>4</sup> Indeed, the majority of the public pension plans are in far better financial shape than are either the Social Security or Medicare Trust Funds and states are actively pursuing solutions for their plans that are facing financial problems.<sup>5</sup> Further, public pension systems are significant economic engines for the total economy.<sup>6</sup> If public pension systems are undermined by the imposition of universal Social Security on all state and local governments the entire U.S. and global economies may be negatively impacted.

**3. Such Action Will Negatively Impact Public Pension Recipients.** Universal coverage will affect more than newly hired public employees. Nearly two-thirds of the

<sup>2</sup> Coalition to Preserve Retirement Security, *The Cost of Universal Social Security Coverage of State and Local Workers*, 9/2011.

<sup>3</sup> *Id.*

<sup>4</sup> *The National Commission on Fiscal Responsibility and Reform: The Moment of Truth*. December 2010, p. 52 (often referred to as the "Simpson-Bowles Report"). Available at: [http://www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/TheMomentofTruth12\\_1\\_2010.pdf](http://www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/TheMomentofTruth12_1_2010.pdf)

<sup>5</sup> See Keith Brainard. National Association of State Retirement Administrators. Public Fund Survey – Summary of Findings for FY 2010. December 2011. See, also, Ronald K. Snell. National Conference of State Legislatures. Pensions and Retirement Plan Enactments in 2011 State Legislatures. January 31, 2012.

<sup>6</sup> See Economic and Fiscal Impact study, dated November 2011, prepared by Pacey Economics Group for the Public Employees' Retirement Association of Colorado, available at: <http://www.copera.org/pdf/Impact/Impact2011.pdf>.

states have restructured retirement benefits since 2010.<sup>7</sup> The process for most states has been difficult and controversial. If Social Security is mandated it will require making additional benefit and/or funding adjustments, which will undermine many of the corrective actions taken by state and local governments and the pension systems that are necessary to ensure the long-term sustainability of those funds for their members and beneficiaries. If mandatory coverage results in separate or restructured tiers for new hires, the existing defined benefit plans will experience a reduction in employer and employee contributions, which are an essential part of their actuarial funding. The result could be a destabilization of the existing plans on which current workers and retirees depend. Lower funding would not only have an impact on retirement benefits, but could affect disability and survivor benefits as well. In addition, governments will be burdened with the cost of operating new plans or tiers. These costs include employee communications, actuarial reviews and plan complexities. As administrative costs are generally paid out of investment earnings, these increased costs could further erode plan assets.

4. **Such Action Would Have a Negative Impact on the National and Local Economies.** It is well founded that public pension benefit payments (benefit payments) have a tremendous positive effect on local and especially rural economies. For example, analyses of the economic impact of pension benefits on the broader economy have been conducted that provide documentation about the "multiplier" effect.<sup>8</sup> Colorado's Public Employees' Retirement Association (PERA) latest study showed the benefit payments by public pensions have a stimulating effect on local economies with an output multiplier of approximately 1.43, which means that for every dollar spent by a pension recipient, an additional 43 cents is generated in the economy through additional rounds of spending.<sup>9</sup>

The positive impact that defined benefit (DB) pensions in both the public and private sectors was well documented by the National Institute on Retirement Security (NIRS) in 2012, based on 2009 data. The NIRS study identified numerous economic gains attributable to defined benefit pension expenditures, including:

- A. Expenditures made out of those payments collectively supported:  
 6.5 million America jobs that paid nearly \$315 billion in labor income;  
 \$1 trillion in total economic output nationwide;  
 \$553 billion in value added (GDP);  
 \$134 billion in federal, state, and local tax revenue.
- B. DB pension expenditures have large multiplier effects:

<sup>7</sup> *Ibid*, Coalition to Preserve Retirement Security, 9/2011.

<sup>8</sup> Pacey & McNulty. Colorado PERA – Economic and Fiscal Impacts, November 2011, p. 12 states: "When a household receives PERA benefit payments, it represents an infusion of income into the local economy that creates a chain of economic activities whose total impact is greater than the initial benefit payment. That is, these payments have substantial 'ripple' or 'multiplier' effects where one recipient's spending becomes someone else's income. With \$3.03 billion paid to recipients who reside in Colorado, PERA has a large economic footprint on the State, regional, and local economies." Full report available at: <http://www.copera.org/pdf/Impact/Impact2011.pdf>.

<sup>9</sup> *Id.* p. 18. Many other states, not just Colorado, have prepared similar analyses of the economic benefits of their state and local pensions; for details, visit the National Association of State Retirement Administrators (NASRA) at: [http://www.nirsonline.org/index.php?option=com\\_content&task=view&id=184&Itemid=88](http://www.nirsonline.org/index.php?option=com_content&task=view&id=184&Itemid=88)

For each dollar paid out in pension benefits, \$2.37 in total economic output was supported;

For every taxpayer dollar contributed to state and local pensions, \$8.72 in total output was supported nationally.

- C. The largest employment impacts were seen in the food services, real estate, health care, and retail trade sectors.<sup>10</sup>

Public plans distribute more than \$150 billion annually (an amount greater than the total economic output of 22 states) in benefits to 7 million retirees, disability recipients and beneficiaries, with an average annual pension benefit of approximately \$20,500. These payments are steady and continuous and provide a considerable benefit to national, state and local economies. Several state-specific studies have documented the significant contributions public pensions make to local and state economies. On the whole, personal income from state and local government pensions exceeds the personal income derived from the nation's farming, fishing, logging, and hotel/lodging industries combined.<sup>11</sup>

There will be severe negative financial implications for state and local governments, their entire state economies, and the national economy of the United States if the approximately 2,500 public retirement systems in the nation<sup>12</sup> are decimated because Social Security is mandated for all public employees. Most public pension plans currently involve combined employee and employer contributions of 21 percent of payroll.<sup>13</sup> If Congress mandates full Social Security for all state and local government employees, it would be financially impossible for the vast majority of state and local governments and their employees to continue contributing to the public retirement systems at the current contribution level while also having to contribute to Social Security. The implications of such a Congressional mandate would be devastating not only to the beneficiaries of those pension systems, but also to the very economy of our country.

Another possible unintended consequence of mandating Social Security for currently exempt state and local government employees is that such actions would, undoubtedly, reduce investment funds, further negatively impacting not only the U.S., but the entire global, economies. State and local retirement plan assets are professionally managed and provide valuable long-term capital for the nation's financial markets. The \$3 trillion in assets held in plan portfolios—and managed by

<sup>10</sup> Ilana Boivie. *Pensionomics 2012: Measuring the Economic Impact of DB Pension Expenditures*, report prepared for National Institute on Retirement Security (NIRS), March 2012, p.1. Report available at: [http://www.nirsonline.org/storage/nirs/documents/2012\\_pensionomics\\_report.pdf](http://www.nirsonline.org/storage/nirs/documents/2012_pensionomics_report.pdf). The NIRS report includes separate fact sheets on the economic impact of DB plans on each state, available at: [http://www.nirsonline.org/index.php?option=com\\_content&task=view&id=683&Itemid=182](http://www.nirsonline.org/index.php?option=com_content&task=view&id=683&Itemid=182).

<sup>11</sup> U.S. Department of Commerce Census Bureau and Bureau of Economic Analysis

<sup>12</sup> U.S. Department of Commerce. U.S. Census Bureau. Governments Division. Table 5b. Coefficient of Variation for Number and Membership of State and Local Government Employee-Retirement Systems by State: Fiscal Year 2003-04. Created: September 28 2005, and last revised: September 28, 2005.

<sup>13</sup> Testimony provided by Ms. Priya Sara Mathur, elected member of the Board of Administration of the California Public Employees' Retirement System (CalPERS) before the Subcommittee on Social Security, Pensions and Family Policy, U.S. Senate Committee on Finance, on November 6, 2007, p. 2.

professional investment managers—are an important source of stability for the economic marketplace and are designed to withstand short-term fluctuations of the financial markets while providing optimal long-term growth potential for the plans. Public pension portfolios are broadly diversified: approximately \$1.74 trillion of public pension assets are held as equities in publicly traded companies; \$850 billion is in corporate bonds and U.S. Treasury Notes and bonds; and another \$150 billion is in real estate.<sup>14</sup> Wilshire Associated, in 2008, noted that the bulk of assets are invested on a long-term basis, creating a stabilizing effect on these financial markets, while public pensions' cash and short-term holdings add essential liquidity. Wilshire also stated that for the 3- and 5-year periods ended 12/31/07, public pension funds generated strong investment returns of 10.0% and 12.7%, closely tracking returns generated by corporate pension plans.<sup>15</sup>

In conclusion, for all of the reasons noted above, NCSSSA urges Congress and the Administration to avoid including universal Social Security coverage for state and local government employees as part of any solution to the federal government's debt, deficit, and budgetary problems. As the data show, public pension plans are economic drivers that minimize the chances that their members and beneficiaries will be a burden on federal, state, and local governments. The defined benefit plans provide the necessary retirement security that governmental employees have earned – the promises made in the past need to be kept in the future.

NCSSSA represents each of the states, Puerto Rico, and the Virgin Islands. Our Leadership Team will be in Washington D.C. March 12<sup>th</sup> and 13<sup>th</sup>, 2014, and available to discuss our position on this vital matter with you or your staff and to provide information as needed. Your consideration of NCSSSA's position is greatly appreciated.

Most respectfully,



Rita Foltman, President (2013-2014)  
National Conference of State Social Security Administrators  
Telephone: 208.332.8734  
Email: rfoltman@sco.idaho.gov

cc: Ms. Vandee DeVore, NCSSSA First Vice-President  
Dr. Maryann Motza, NCSSSA Vice-President Designate and Legislative Committee Chair

<sup>14</sup> National Association of State Retirement Administrators and National Council on Teacher Retirement, Public Fund Survey, 7/8/08.

<sup>15</sup> Wilshire Associates, Trust Universe Comparison Service, 2/13/08






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**Ohio Public Employees Retirement System**

December 30, 2013

The Honorable Sherrod Brown  
 United States Senator  
 713 Hart Office Building  
 Washington, D.C. 20515

RE: **The Role of Social Security, Defined Benefits, and Private Retirement Accounts in the Face of Retirement Crisis. Hearing on 12/18/13 at 10:00 AM**

**Ohio Public Employees Retirement System, Karen Carraher, Executive Director,  
 277 East Town Street, Columbus, OH 43215**

Dear Chairman Brown,

I am writing on behalf of the Ohio Public Employees Retirement System, its Board of Trustees and our more than one million members to express support for public pension defined benefit pension plans nationwide, and to share OPERS' experience as a provider of retirement benefits for Ohio's public employees.

It is no surprise that public sector defined benefit retirement systems have come under increased scrutiny in recent years. To be sure, there are plans that have struggled in recent years, but they are relatively few in number and not representative of the public pension defined benefit plan community as a whole. The municipal bankruptcy filing in Detroit, towns in California, and rumors of pension insolvency in Illinois and Pennsylvania are making headlines and drowning out the real story: American workers are facing a looming retirement crisis, not because of underfunded pension systems, but because the vast majority of them may never experience true retirement security.

OPERS has been providing retirement security to Ohio's public employees for more than 78 years. Currently, we have more than \$86 billion in trust, are 81 percent funded, and our 26-year amortization period is well below Ohio's statutory maximum of 30 years.

Our economic footprint in Ohio is significant: we have invested over \$1 billion in Ohio companies, and we pay more than \$6 billion in pension and health care benefits every year, the vast majority of which remains in the state. This means that for every \$1 the taxpayers contribute to Ohio, we return more than \$3 back into the state and local economies, supporting economic development and helping to preserve jobs. More importantly however, is the fact that our members may not be forced to rely on social services to make ends meet; rather they are productive and tax-paying members of society.

Certainly, we owe much of this success to our unique situation within Ohio. Our contribution rates are set in statute and provide public employers with a



stable rate for budgeting purposes. We are fortunate that the state has never missed a payment to any of Ohio's public retirement systems, and we believe our financial strength is reflective of that discipline.

But, there is another factor that makes Ohio different in regard to retirement policy: Ohio's public employees do not participate in Social Security. OPERS predates the Social Security system, and in fact, our members were prohibited from joining that program for many years. When Congress decided it would allow voluntary participation – or later, to compel participation – in Social Security, Ohio had developed a system of vibrant and financially sustainable retirement plans covering the various public employee populations within the state. It is important that we remain vigilant against any attempt to disrupt or harm these systems, including proposals that would mandate public employee participation in Social Security.

The Ohio Congressional Delegation has long been a force against these types of mandates, and for good reason. The additional contributions required to participate in Social Security would be unduly burdensome to our members and employers. If, on the other hand, the money was simply reallocated from our current contributions, the resulting loss of income to Ohio pension systems would be catastrophic, necessitating drastic and immediate benefit reductions and termination of post-retirement health care coverage, at the least.

As such, I would be remiss not to remind you of the sustainable and successful retirement systems that the people of Ohio have created and the General Assembly has maintained over many years, and ask you to oppose any measure that would harm those systems.

Thank you for your support, not only of OPERS, but of the many sustainable public pension defined benefit retirement plans across this nation.

Sincerely,

A handwritten signature in cursive script that reads "Karen Carraher".

Karen Carraher  
Executive Director



**SCHOOL EMPLOYEES RETIREMENT SYSTEM OF OHIO**

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**U.S. Senate Committee on Finance  
Subcommittee on Social Security, Pensions, and Family Policy  
Hearing on  
The Role of Social Security, Defined Benefits and Private Retirement Accounts  
December 18, 2013**

**Statement for the Record  
Submitted by  
Lisa J. Morris, Executive Director  
School Employees Retirement System of Ohio**

Chairman Brown, Ranking Member Toomy, and Members of the Subcommittee on Social Security, Pensions, and Family Policy, thank you for the opportunity to provide this statement for the record on the importance of defined benefit plans in planning retirement security, and the disadvantages of requiring that all newly hired Ohio public employees join Social Security.

School Employees Retirement System of Ohio (SERS) is the public retirement system for all nonteaching public school employees in the state. SERS' members include school bus drivers, custodians, administrators, food service workers, secretaries, and educational aides – all workers who perform the vital, day-to-day operations that allow our schools to run safely, efficiently, and effectively for our children.

SERS was established in 1937, nearly pre-dating the formation of Social Security. At that time, states whose public workers already had an opportunity for retirement security through an existing public retirement system were specifically excluded from Social Security.

Since then, protecting and growing the retirement contributions of our 190,000 active and retired members has been our top priority.

Today, SERS provides guaranteed pensions, disability and survivor benefits, and access to comprehensive retiree health care coverage.

As a defined benefit pension plan, each year SERS pays out more than \$1 billion in pensions and health care reimbursements. With 91% of our retirees living in the state of Ohio, the vast majority of those reimbursements stay here, providing a needed economic boost to the state.

The embedded economic efficiencies of defined benefit plans – longevity risk-pooling, optimal asset allocation, professional management, and lower fees – enable our members to achieve retirement security at half the cost of defined contribution plans.

Defined benefit pension plans like SERS are part of the solution to America's retirement savings crisis, not the problem.

The way Ohio structured its pension plans is the key: contribution rates are set in statute, and not part of the state's operating budget. The pension plans are set up as independent trusts, with the Boards as the ultimate fiduciaries. The Boards' ability to adjust benefits removes the risk of insolvency and the need for much-hyped "bail-outs."

With regard to requiring that all newly hired Ohio public employees join Social Security, the Segal Company released an updated study in 2011 estimating that the additional cost to Ohio and the affected public employees would top \$6.3 billion over the first five years. Sadly, those additional contributions would only buy a short-term extension of Social Security's solvency period, while adding hundreds of thousands of new beneficiaries.

If all existing public employees were required to join Social Security in lieu of their Ohio public pension plan, the result would be devastating to the plan's current members and retirees – making pension benefit cuts and termination of health care coverage almost a certainty.

For all the above reasons, in 2013 the Ohio General Assembly again reaffirmed the state's long-standing policy toward its public retirement systems and Social Security coverage. House Concurrent Resolution 19 memorialized the Congress of the United States to oppose any legislation that requires Social Security coverage for members of Ohio's public retirement systems.

In conclusion, SERS' members are far more secure in their retirement years because they have a defined benefits pension plan rather than a defined contribution plan with Social Security.

Ohio's policymakers, and the state's public employees, urge the Congress to foster innovative solutions that will bring back the retirement security of defined benefit pension plans for all Americans.



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U.S. Senate Committee on Finance  
Subcommittee on Social Security, Pensions and Family Policy

The Role of Social Security, Defined Benefits and Private Retirement Accounts

December 31, 2013

Statement for the record submitted by  
Michael J. Nehf, Executive Director  
State Teachers Retirement System of Ohio

RETIREMENT BOARD CHAIR  
DALE PRICE

RETIREMENT BOARD VICE CHAIR  
ROBERT STEIN

EXECUTIVE DIRECTOR  
MICHAEL J. NEHF

Chairman Brown, Ranking Member Toomey and Members of the Subcommittee on Social Security, Pensions and Family Policy, I am pleased to have this opportunity to submit for the subcommittee's record a statement on behalf of the State Teachers Retirement System of Ohio board and our 480,500 retirees and members.

#### **Ohio public employees are not covered by Social Security**

Created by the Ohio legislature in 1920, the State Teachers Retirement System of Ohio is the oldest of the five public retirement systems serving Ohio's public employees, and actually predates the establishment of the Social Security Administration (SSA) by 15 years. Furthermore, the statutes forming the SSA prohibited the inclusion of public employees who were covered by systems such as STRS Ohio. Consequently, the critical role of providing for retirement security for these employees falls mainly to the five Ohio state systems, as well as personal savings accumulated by the member. For that reason, there has been significant involvement by Ohio's General Assembly in the oversight and regulation of the retirement systems since their inception. More specifically, since 1969, the Ohio Retirement Study Council (ORSC), comprised of three members of each chamber of the legislature and three gubernatorial appointees as well as the five system directors serving as non-voting members, regularly receives reports from the systems. The ORSC also reviews all legislation that would affect the systems. Thus, the systems have and continue to be accountable not only to the respective retirees and members, but also to the public at-large.

This fall, the Ohio General Assembly adopted House Concurrent Resolution (HCR) 19 that *memorializes Congress to not pass legislation that would contain a Social Security mandatory coverage provision*. HCR 19 is the most recent in a list of such resolutions from the Ohio legislature asking Congress to not pull Ohio public employees into Social Security.

#### **Mandatory Social Security coverage would harm Ohio public employees**

Mandatory coverage does not solve the Social Security funding problem, but does greatly lessen the financial security of Ohioans who chose careers in public service. Mandating Social Security coverage for all public employees would likely lead to reduced pensions and critical benefits, such as disability coverage, for current and future employees. Furthermore, supplemental benefits such as cost-of-living adjustments and health care coverage would either have to be reduced or eliminated for retirees. The impact of new taxes and reduced services and benefits would affect more than one million Ohio public employees – new, current and retired. After a career in public service, these employees,



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including teachers, school bus drivers, firefighters and police officers, deserve better than to have their retirement benefits cut by such a drastic change.

Mandating Social Security coverage would not only be devastating to public employees, but would also harm employers and the pension systems that have provided reliable retirement security for decades. The cost to the state of Ohio would be nearly \$5 billion in the first five years, according to a report by the Segal Company.

#### **Most STRS Ohio members participate in a stable defined benefit plan**

Since 2001, STRS Ohio has offered new members the option to choose between a defined benefit plan, a defined contribution plan or a hybrid of the two. Currently, about 90% of STRS Ohio members are enrolled in the Defined Benefit (DB) Plan. Those members are working toward a service-based benefit, consequently, the longer a member works, the greater the monthly benefit in retirement. A highly desired aspect of the DB plan is the fact that retirees can count on receiving the monthly benefit regardless of the volatility that the financial markets may be experiencing. They don't have to agonize over setting aside enough money to make certain they don't outlive their assets. Furthermore, they have access to the STRS Ohio Health Care Program, something DC participants currently don't have the ability to access. While working, the member's dependents receive a monthly benefit should the member pass away and the member is also covered should he or she become disabled.

To strengthen the financial condition of the pension fund following the Great Recession, the State Teachers Retirement Board developed a plan to seek statutory modifications to the pension plan design. The changes had the support of the system stakeholders, including beneficiaries, active members and employer groups, but meant that members would be contributing more, working longer and getting a lesser benefit in retirement. These pension reform changes still represent good public policy for helping to maintain financial security for Ohio's older citizens and provide an economic boost to the state. Dependable retirement income provided by defined benefit plans helps taxpayers, too. Consider:

- **Defined benefit pensions provide financial protection for both plan members and taxpayers.** Members are provided a lifetime benefit they won't outlive — a problem now faced by so many whose savings or 401(k) plans were depleted by the recession. They now face the possibility of slipping into poverty in their "golden years," having to turn to taxpayer-funded public assistance, Medicaid or social services. Ohio is already struggling to budget a higher level of resources to cover new people seeking assistance.
- **Defined benefit pensions are both efficient and economical.** A 2008 National Institute on Retirement Security (NIRS) report found that a defined benefit pension could deliver the same retirement income at almost half the cost of a defined contribution account due to pooling of investment risk, continual diversification of assets and professional investment management. The cost to manage a 401(k)-style defined contribution account is about \$1 per \$100 of assets. Due to managing the majority of its investment assets in-house, STRS Ohio's investment management costs are about \$.31 per \$100 of assets.

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DALE PRICE

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ROBERT STEIN

EXECUTIVE DIRECTOR  
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• **Public pensions provide a stable source of revenue for Ohio's local economies.**

Together, Ohio's statewide public retirement systems serve nearly 685,000 active members and more than 410,000 retirees — most of whom live in Ohio. The systems provide a stable source of revenue for Ohio's local economies, paying more than \$14.4 billion annually in pension and health care benefits. These systems invest in Ohio, too — holding more than \$3 billion in investments in companies with a major presence in the state.

In conclusion, I would, again, like to thank Senators Brown and Toomey and the members of the Subcommittee on Social Security, Pensions and Family Policy. I would also like to emphasize the following:

- Ohio public employees are not covered by Social Security and are adamant in their desire to remain outside the system;
- Including Ohio public employees in Social Security would be devastating to the retirement security of the retirees and members covered by the state plans;
- The benefits administered by STRS Ohio have a positive economic impact on the retiree, the active member and their community; and,
- Despite some press coverage, defined benefit plans, particularly those in Ohio, are sustainable and the legislators, system board and stakeholders have and will continue to monitor the plans' financial viability and will take the necessary steps to ensure the systems remain a source of retirement security.

STRS Ohio has provided retirement security for more than 90 years, and with your support, the retirement system will have the ability to offer the same peace of mind to generations of educators to come.

